RECONSTRUCTION OF INDIA'S FOREIGN TRADE

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NEW DELHI
INDIAN COUNCIL OF WORLD AFFAIRS

BOMBAY CALCUTTA MADRAS LONDON
OXFORD UNIVERSITY PRESS

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First Published August 1946

PREFACE

This book has grown out of a course of Readership lectures delivered at the University of Delhi three years ago. Much earlier I had projected a work on India's Commercial relations with the rest of the world on the basis of data which I had been patiently collecting from various sources. A part of the accumulating material has gone into the making of Chapter 3 of this book in which I have tried to break new ground and visualize Indian trade from a new angle. But the entire plan of the book was reconceived in the context of a war-torn post-war world, and it was actually written under the shadow of a war fast approaching a climax. While trying to catch up with the bewildering sequence of events towards the end of the war and immediately after it, I had periodically to review my facts and conclusions. This is a process which is hardly pleasant to an author, but the delay in the completion of this work which was due to lack of sufficient leisure and which prolonged this trying process had the compensatory effect of making my study more in accord with the economic trends of a more enduring character as revealed by recent events.

The reader will at once observe that I have devoted a good deal of attention to the problem of India's foreign trade, her trade relations in the inter-war period and the alternatives of commercial policy, which form the subject-matter of the first three Chapters. In these Chapters I have tried to set India in the pattern of world economy as it existed before the war. I think that such facts as I have presented will be a necessary corrective to half-baked mercantilist and autarchic ideas which unfortunately have shaped a considerable section of even informed opinion and which are often brought to bear upon problems of India's foreign trade. India cannot afford to be a closed economic circuit. Economic isolationism, like political isolationism, is an outmoded philosophy, and, what is more, an unsound business proposition. This may seem a truism, but it does require demonstration in a country which, for many reasons, has been isolated from the world forces. But objectively I have not lost sight of the fact that inter-

national trade has been an instrument of " power economics ", to quote Condliffe's appropriate expression, and of power politics, and this largely explains a nation's defensive attitude to foreign trade. Hence although the objective of reasonably free and non-discriminatory multilateral trade which should lead to the formation of a world economy is, in the existing circumstances, a broad strategy of world peace, yet it is neither reasonable nor safe to forget that it is the short-period tactics of national economic policies which are bound to supervene and which should, by international agreement, be made to evolve themselves within the pattern of this broad strategy. I have discussed in this connection how the multilateral trading system is likely to be refashioned after the war and the advantages and handicaps of backward economies aiming at primary economic development. The special problems of such economies are apt to be forgotten by advanced industrial countries who talk of removal of trade barriers. In fact India's right to " developmental protection " should in no circumstances be circumscribed; nor should trade barriers of a planned and regulatory character designed to raise the level of our economic life, be regarded as inconsistent with the so-called liberal trading conditions, provided, of course, they are non-discriminatory as regards treatment of foreign nations.

The general principles and objectives of the reconstruction of foreign trade have been formulated not only in the light of these broad considerations, but also on the basis of planned development of welfare in this country. Economic planning in India has no illusions (optical or otherwise) for me. But I feel that in spite of bottlenecks, corruption and inefficiency, planned direction of the nation's economic life by a really people's government cannot be avoided on a clear estimation of possibilities. At least this is an economic datum and assumption on which I have based the argument presented in this book. As a matter of fact the instrumentalities of trade regulation and control which I have advocated can operate in the best interests of the country only on this basic assumption. At this point economics and politics impinge on each other. And, as I have emphasized, if the political atmosphere

is cleared as the result of a real political settlement between Great Britain and India, India, as an autonomous economic Unit, will be in a position to find a wide and expanding basis of mutually advantageous trade with Britain and the rest of the world. A good deal will depend upon the growth of an expansionist world economy which should raise the level of life all the world over. With the expansion of world employment and consequently of world trade (and not the other way round, as the Anglo-American world trade proposals put it) a real world economy with freer trading conditions will arise, and trade barriers which are essentially due to uneven economic development and uncoordinated national recovery programmes, will be much less a question of "power economics" than it is now. Till then India, I am afraid, will have to pursue a cautious and realistic foreign economic policy.

It remains for me to express my thanks to those who have assisted me in my work. I owe a debt of gratitude to Sir Maurice Gwyer, Vice-Chancellor, University of Delhi, who has watched the progress of this work with great interest and whose appreciation of scholarship has been a source of strength to many a researcher in the University of Delhi. My friend and colleague, Dr. V. K. R. V. Rao, has sustained me in my work by his infectious enthusiasm for knowledge. In the midst of his heavy official duties he found time to read and discuss with me a considerable part of the manuscript. I am grateful to him for his friendly advice and stimulating criticism. I am also grateful to my esteemed friend Dr. P. S. Lokanathan whose unfailing appreciation of certain points of view which I have expressed in this book has stimulated thought and sharpened my intellectual reactions. I have to thank my friend, Dr. A. Appadorai, Secretary, Indian Council of World Affairs, who has seen this book through the press with meticulous care. My thanks are also due to my pupil, Mr. Raj Krishna, M.A., Research Fellow of the Hindu College, for taking the trouble of compiling the index.

University of Delhi,
April 29, 1946.

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CHAPTER I

STRUCTURE AND DYNAMICS OF INDIA'S FOREIGN TRADE

A study of the structure and dynamics of our foreign trade must precede any planning of its reconstruction. If the internal economy of India has to be planned with a view to attaining a higher level of efficiency and welfare, the structure of our foreign trade will have to be profoundly modified in consequence, so that it should reflect the dynamics of a changing economy which is moving to a new equilibrium. But since the structure of our foreign trade reveals the weakness of our internal economic structure, a study of the former indicates not only the limits and dimensions of internal economic development, but also the changes which must be sought in the character of our foreign trade and the channels through which it flows. But there must not be a swing of the pendulum to the opposite extreme. To be misled by half-baked, autarchic conceptions would be a serious folly. Even the most robust optimist will admit that industrial development in India of any significant magnitude will take at least a generation after the war. In the period of transition India will have to plan a stable basis of foreign trade not only in the interests of agriculture, but also to obtain at least her requirements of capital goods. Even later she will not necessarily be a closed economic circuit. A predominantly agricultural country even with a considerable degree of industrialization, she will find herself in the ranks of advanced primary countries which in favourable circumstances may have an expanding scope for mutually advantageous trade with both predominantly industrial countries and primary producers.[1] To gain a clear perspective it is necessary for us

1. A good deal of loose thinking may be traced to the fallacy of looking at world trade on traditional lines as trade between industrial and agricultural countries. There is a considerable volume of mutually advantageous trade as between industrial countries, as between agricultural countries, and also as between agricultural and industrial countries.

to study the broad structure of our foreign trade in an international setting.

Countries in which primary production is the principal source of livelihood may be conveniently divided into two broad categories :—(1) Tropical countries, and (2) Advanced Primary countries. The countries which come under the Tropical group are Nigeria, Gold Coast, Ceylon, Malaya, British West Indies, Dutch East Indies, French West Africa, Egypt, Columbia, Cuba and Venezuela. The Advanced Primary group includes the following countries :—The Union of South Africa, Southern Rhodesia, Canada, Australia, New Zealand, Ireland, Argentina, Denmark, Norway, Sweden and Greece.

Most of the countries included in the Tropical group are characterized by a comparatively low average standard of life. In many the production of exports was before the recent war under foreign control. The value of export trade per head of population was comparatively small in the case of this group of countries. The Advanced Primary countries, on the other hand, are more independent politically and economically, and their national standards of living are far higher. The value of exports per head of population is very large in the case of this group of countries, so that they have a substantial stake in foreign trade. Except Rhodesia and Australia, all of them lie outside the tropics. India cannot be conveniently classed under either of the two main groups. The standard of life in India is as low as that in the Tropical group. The value of export trade per head of population is almost insignificant. But the country depends much less on the export of primary products than the countries of the Tropical group. As regards the nature of exports, the tropical countries and India specialized before the present war in cotton, groundnuts, palm products, tea, cocoa, coffee, sugar, tin, rubber and petroleum, while the Advanced Primary countries exported grain, tobacco, meat, wool, butter, wood and pulp, and gold.

Of the 24 countries comprised in the two groups 13 were within the British Empire before the war. In addition 5 (Egypt, Argentina, Denmark, Norway and Sweden) were linked, as members of the Sterling Area, with Great Britain

with the closest of economic and financial ties. In all of these 18 countries Great Britain enjoyed the advantage of special treatment secured by quotas, tariff preferences or favourable trade agreements.

The peculiar position of India in the ranks of agricultural countries may be illustrated by the following tables :[2]

Tropical Countries	*Exports per head of population* 1937 (Old gold dollars)
Nigeria	.. 3·0
Gold Coast	.. 14·1
Ceylon	.. 12·0
Malaya	.. 64·0
British West Indies	.. 20·6
Dutch East Indies	.. 4·6
French West Africa	.. 2·7
Egypt	.. 7·3
Columbia	.. 7·0
Cuba	.. 26·7
Venezuela	.. 39·4

Advanced Primary Countries	*Exports per head of population* 1937 (Old gold dollars)	*Exports as percentage of national income* (1925-1934)
The Union of South Africa	37·4	40
Southern Rhodesia	24·3	..
Canada	60·0	18
Australia	50·4	17
New Zealand	98·0	28
Ireland	22·0	21
Argentina	35·6	..
Denmark	53·7	32
Norway	41·2	21
Sweden	47·9	17
Greece	7·4	14
India and Burma	1·2	13

2. The figures have been taken from Table 1 on p. 2 of *Overseas Buying Power* (1939) published by the Economic and Statistical Department of the Joint Committee of Cotton Trade Organizations, Manchester.

The striking fact which emerges from these figures is that in the case of India the value of exports per head of population is the lowest in the scale. The tropical countries show a much higher value of export trade per head, but since primary production, the principal source of livelihood for the great majority of the population in these countries, has been stimulated by colonial development based on the ownership and exploitation of economic resources by foreigners, the higher value is not correspondingly reflected in the per capita income of the native inhabitants of these countries, which is notoriously low. In the case of Advanced Primary countries the appreciably higher per capita value of exports is correspondingly reflected in the high per capita national income. There has been considerable internal economic development in most of these countries during the last few decades. This explains why in the case of countries like Sweden, Australia and Canada the value of exports expressed as a percentage of the national income is not so high, and export trade is not indispensable for the maintenance and progressive rise of the level of national income. But this does not mean that these countries have ceased to take an intelligent and enlightened interest in their export trade. It is possible to visualize India's economic future in the light of these facts. She must leave the ranks of tropical colonies and advance on the lines of such Advanced Primary countries as have developed manufacturing industries and have not failed to find a sound basis of mutually advantageous trade with the rest of the world.

Apart from the economic and financial ties of a political or semi-political nature, the important factors which determine the position of a country specializing in primary production in relation to its foreign trade are (1) its dependence on foreign trade; (2) the extent of export specialization; and (3) the nature of the commodities exported. If a country's primary production is almost entirely determined by foreign demand, her national income fluctuates with fluctuations of the export market. If, at the same time, she specializes in a narrow range of commodities, her economic position becomes more vulnerable. If, again, the commodities exported by her are also such that their prices are liable to wide and simul-

taneous fluctuations, her economic position becomes still more vulnerable and precarious. A combination of all the three factors is perhaps rare. Of the three factors the second needs special emphasis. The wider the range of export specialization, i.e., to put it in technical language, the larger the number of actual and potential export-goods included in the range of a country's exports—the more many-sided a country's economy—the more improbable is an inelastic demand for her exports, and the less serious the deterioration of the terms of trade caused by adverse shifts of foreign demand, unilateral transfer of funds, etc. This means that a country may produce commodities whose prices are liable to wide fluctuations, but if she has the advantage of a many-sided economy and resourcefulness of supply she can build up a stable structure of export trade. The degree of export specialization in the case of the two groups of agricultural countries is indicated by the Indices of Dispersion which have been constructed by the author of *Overseas Buying Power* and are tabulated below.[3]

Tropical Countries	*Index of Dispersion*	*Advanced Primary Countries*	*Index of Dispersion*
Nigeria	.. 78	Union of S. Africa	.. 43
Gold Coast	.. 54	Southern Rhodesia	.. ..
Ceylon	.. 56	Canada	.. 89
Malaya	.. 70	Australia	.. 77
British West Indies	.. ..	New Zealand	.. 80
Dutch East Indies	.. 91	Argentina	.. 79
French West Africa	.. 73	Ireland	.. 79
Egypt	.. 33	Denmark	.. 84
Columbia	.. 61	Norway	.. 93
Cuba	.. 46	Sweden	.. 85
Venezuela	.. 20	Greece	.. 72
India and Burma	.. 90		

3. ibid., p. 4. Table 3. The higher the Index the more widely spread and the less specialized is the country's export trade.

The author of *Overseas Buying Power* comments that a single commodity accounts for a half or more of the total exports of the Gold Coast (cocoa), Ceylon (tea), French West Africa (groundnuts), Egypt (cotton), Cuba (sugar), Columbia (coffee), Venezuela (petroleum), South Africa (gold) and Ireland (meat). The structure of trade of the Advanced Primary group is in nearly all cases more diversified. The Dutch East Indies (with petroleum, rubber, tin and tea as the main exports) and Norway (with fish, wood, paper, etc.) are among the least specialized primary producers. At the other extreme are the 'one commodity' countries, Egypt and Venezuela. It must be noted that *the export trade of India is comparatively well-diversified and ranks with that of Canada and Norway.*

But it must be remembered that the risk inherent in specialization in the case of countries specializing in primary production depends not only on the *range* of specialization but also on the *nature* of commodities exported. The Dutch East Indies exports several commodities the prices of which are liable to violent and simultaneous fluctuations. Her economy is, therefore, unstable in spite of the fact that her export trade and her economic structure are broadbased and diversified. On the other hand, the trade of Denmark is less diversified, but is more stable, because the prices of her exports are less liable to wide fluctuations. The course of the Great Depression of the 'thirties has clearly shown that the volume of exports as well as export prices have fluctuated more widely in the case of the Tropical group of countries than in the case of the Advanced Primary group. India's export production is diversified, but like the Dutch East Indies she possesses an unstable structure of export trade *because of the character of goods exported.*

This chapter almost began with the proposition that the structure of India's foreign trade should be shaped by the dynamics of a changing internal economy which is expected to move towards a higher level of efficiency and welfare during the post-war period. Since 1870 it is India's internal economy which has been activated and moulded into shape by the dynamics of her foreign trade—a process which, on the whole, is on a par with the process of primary economic development

in undeveloped countries, including not only colonies and dependencies, but also many countries which occupy today a high place in the ranks of Advanced Primary countries. Thus it is easy to see that the basic principle of reconstruction of foreign trade contemplated in this work involves a break with the past. A broad view of the dynamics of our foreign trade since 1870 would be a necessary perspective in this context, because it will not only help us to understand an important chapter of India's economic history, but also yield conclusions which will have an important bearing upon our future trade policy.

The remarkable development of India's foreign trade after 1870, and particularly the active merchandise balance of trade (export surplus), which has been a normal feature of her foreign trade, have been regarded by many as symptoms of national privation rather than national prosperity. One may try to defend this position with the help of the theory of unilateral transfer of funds which came into prominence after the last war in connexion with the controversy on the effects and limits of German reparation payments and similar large, one-way transfers of funds in settlement of war debts. A unilateral transfer of funds from one country to another may be occasioned by (1) payment of a political tribute, such as reparations; (2) liquidation of indebtedness arising out of war debts or capital development in an industrially backward country in the past; (3) meeting the external financial obligations of the Government, such as annual debt charges, pensions and railway annuities in the case of India; and (4) the necessity of importing essential capital goods, such as machinery and stores in the present phase of industrial development in India, etc.[4] According to the theory of unilateral transfer of funds, such unilateral transfer turns the barter terms of trade against the country making the transfer,

4. International commercial relations are normally characterized by a bilateral or multilateral transfer of goods, and/or services, and/or assets from one country to another. This normal condition of international trade must be contrasted with the situation in which there is a large unilateral transfer of funds which has to take the form of transfer of goods in the absence of services or assets.

and forces it to exchange a larger quantity of exports in exchange for a given quantity of imports. Consequently the export surplus that is created and the increase in the quantum of exports that is brought about in such circumstances are but an indication of the economic privation that the country was undergoing rather than a symptom of any increase of national income. It may be plausibly argued that India has been in the position of such a country since 1870.[5] In the latter part of the 19th century India was probably returning the loans and definitely paying interest on loans taken earlier. So a certain part of our exports must have been in the nature of forced transfers. Until comparatively recent times the external obligations of the Government of India were considerable, while payments for the imports of machinery and stores during the period of modern economic development were calculated to increase the pressure of the unilateral transfer of funds on the export trade. Hence according to this line of reasoning the growth of India's export trade has imposed a disproportionate burden on the agriculturists and forced them to sell 'non-paying' crops like cotton on unfavourable 'real' terms of exchange. The correct policy, therefore, is not only to stop, but also to reverse, this process in the interests of the masses of the agricultural population.

It is necessary to examine more carefully a theory which leads to such a startling conclusion. When there is a one-way transfer of funds the country making the transfer must eventually show an export surplus, since the balance of payments cannot be out of equilibrium in the long run. How is the export surplus created? If the funds intended for one-way transfer or export are raised by taxation (as in the case of reparation payments) then the purchasing power of the nation is reduced, the quantity of money in circulation contracts and prices fall. On the other hand, in the country receiving payment national income increases, the quantity of money expands and prices rise. The level of prices in the country making the unilateral transfer being comparatively

5. It is said that even much earlier the transfer of political tribute in the form of gold provided the financial basis of industrial revolution in England.

low, her imports are restricted and an export surplus is created. Keynes argues that an export surplus has to be created by lowering the prices of export goods. The extent to which they will be lowered will depend upon the nature of the foreign demand for the exports of the country trying to create an export surplus. If a slight fall in price stimulates foreign demand considerably then the problem is not difficult. But if the conditions of foreign demand are unfavourable, to take an extreme case, no increase in exports, however large, could produce a surplus in terms of value. In the case of India it has to be seen whether the foreign demand for her exports has had sufficient elasticity or not. Keynes further argues that, if a country can create an export surplus of the size required by her foreign obligations only by a large reduction in the prices of exported goods, there is an 'extra loss', apart from the direct burden of taxation which she has to bear in order to meet the unilateral financial obligation. This is the loss represented by the movement of the 'real' ratio of international exchange of goods, or the commodity terms of trade, against the country in question.

As a piece of abstract reasoning the theory of unilateral transfer of funds is not unexceptionable. One cannot assume that in the countries receiving unilateral payments the character of the demand for imported goods and its responsiveness to a fall in their prices will remain unchanged. Owing to the increase of money incomes in these countries, a larger amount of imports will be purchased at the old prices, provided, of course, there are no obstacles to trade. Thus if the increase in foreign demand offsets the decrease in home demand (owing to the fall of incomes in the country making a unilateral transfer of funds), then a country can effect a unilateral transfer of funds without facing a fall in the prices of her exports. Secondly, as Keynes has himself admitted, price-discrepancy (which always implies a change in the terms of trade), which is the essence of transfer difficulties, is relevant almost exclusively to the process of transition and is not germane to the long-run adjustment. Thirdly, the extent of the fall in export prices due to unfavourable terms of trade should not be exaggerated. Foreign demand is, as a rule, very elastic, since the world market is, after all, large

in relation to the volume of exports from any single country, say, India. Moreover, the circumstance that India does not enjoy a complete monopoly in respect of her important exports, but competes with other sources of supply, also works in the same direction. A fall in the prices of exports (assuming that it was brought about by the unilateral transfer of funds) might not only stimulate demand as a whole, but also oust some of her competitors from the international market and cause a larger absorption of Indian exports. The extent of the fall in export prices depends also on the conditions of supply in the country making unilateral transfers as well as in the competing countries abroad. If, for example, India could increase the production of exports under diminishing costs per unit, her transfer difficulties would be reduced. There is no reason why this should not happen if there is planned development of agriculture as well as of some of the manufacturing industries which can find an export market. It is not easy to say how the various factors noted above will work in actual life. Generally, however, it may be asserted that the longer the period allowed for the forces of supply to work themselves out fully, the smaller will be the necessary price change.

Apart from the reservations and limitations by which the theory of unilateral transfer of funds must be qualified, we should consider how far the transfer problem is at all relevant to the dynamics of India's foreign trade. The usual concrete illustration of unilateral transfer of funds is found in the case of countries paying war indemnities and reparation. But a typical instance, which may have some resemblance to the Indian problem of foreign trade, is the transfer problem which arose in the case of Canada. Canada borrowed the colossal sum of 2,545,627 thousand dollars for industrial development during the period 1900-1913. This vast movement of capital (a unilateral transfer from the lending to the borrowing country in the first instance) came abruptly to an end at the outbreak of the last war. During this period Canada's balance of trade became passive with considerable import surpluses; there were large imports of gold and a consequent increase in the volume of currency; Canadian prices rose above the world price level, and since Great

Britain was the most important creditor of Canada, British prices fell in relation to the world price level. Thus there was a fall in Canada's import prices and a rise in her export prices. During the period of the Great Depression of the 'thirties the tables were turned. While international lending ceased, the pressure to maintain an export surplus for meeting the increasing burden of fixed debt charges moved the terms of trade violently against Canada. She had thus to face serious transfer difficulties. India also imported capital on a fairly large scale both on Government and private account for internal economic development after the middle of the nineteenth century. But how can it be assumed that the transition through which Canada passed after 1913 had started in India during the latter part of the nineteenth century? India might have been returning a part of the loans taken earlier. But to prove the thesis that the terms of trade had gone against her owing to the pressure of unilateral transfer of funds somehow creating an export surplus, it must be shown either that the stream of foreign lending had suddenly dried up, as in Canada after 1913 and again after 1929, or that repayment of loans and/or payment of interest charges very much exceeded fresh borrowings during the period of the rapid growth of her foreign trade. Countries which borrow abroad habitually, but whose borrowings are not so large that the annual interest charges and/or repayment of principal shall equal the new and additional capital that they may borrow each year, may be described, in the language of Dr. T. H. Boggs, as 'Immature Borrowers'. The trade balance of such countries would be marked normally by an excess of the value of imports over the value of exports. On the other hand, countries which borrowed in the past so large a volume of capital that the annual interest charges and/or repayment of principal exceed the amount of new capital that they may annually borrow, could be called 'Mature Borrowers'. Their trade balance would show an export surplus. Until recently India *was* in the position of a mature borrower. But it cannot be definitely said when she passed from the stage of being an 'immature' borrower to the stage of being a 'mature' borrower.

The theory of unilateral transfer of funds may not explain the dynamics of our foreign trade in the latter part of the 19th century and the first quarter of the present century. But there is no doubt that between 1929 and the outbreak of the present war the dynamics of our foreign trade was largely governed by the painful necessity of making a unilateral transfer of large funds which characterized the normal economic relations between a mature borrower like India and a mature lender like Great Britain. During this period India shared the common fate of heavily indebted agricultural countries, like Canada, Australia and Argentina. In nearly all the tropical countries, as also in India, the depression in the export trade from 1928-29 to 1932-33 was principally a fall of prices, while the volume of exports slightly increased, because many primary producers attempted to maintain their incomes by increasing their output as prices fell. The worsening of the terms of trade between agricultural and industrial countries during this period was not merely due to temporary economic dislocation. The inter-war period witnessed a large excess of productive capacity in respect of practically the entire range of agricultural products that enter into world trade, and, paradoxically enough, the improvement in agricultural technique aggravated the situation. Upon the difficulty of finding an export market faced by a country with an inefficient system of agricultural production like India, was superimposed an acute transfer difficulty which exerted a pressure in the direction of an increase of exports and made the real ratio of international exchange still more unfavourable.[6]

6. The author has demonstrated in his *Whither Rupee?* how the equilibrium in the balance of payments was maintained during this period by large exports of gold, since our imports did not adequately adjust themselves to the lower level of exports owing to many causes, the most important of which was the currency policy of the Government of India.

Chapter 2

TRADE RELATIONS IN RETROSPECT

The evolution of a rational trade policy for India in the post-war period cannot proceed on sound lines unless we can form some idea of the framework of India's trade relations with the rest of the world which is likely to be moulded into shape after the war. Although the past would be irrevocable in large terms for many reasons, yet since it is bound to be a valuable guide to the future, it is proposed in this chapter to present a synoptic view of India's trade relations with the rest of the world and the vicissitudes through which they have passed during the inter-war period.

International trade reflects the economic interdependence of nations. But a country's import market may not exactly coincide with her export market, for the requirements of any two countries for each other's products need not be equal in volume and intensity. Hence as soon as trade ceases to be mere barter, necessity is felt for the multilateral settlement of reciprocal obligations. Deductive economic reasoning has recognized the need for triangular and multilateral trade which is nothing but a truism. But economists have scarcely realized that international economic interdependence has until recently exhibited a complex, integrated pattern owing to the constancy of the trade routes through which international trade has flown since the 'seventies of the last century, and that a world economy has grown out of a multilateral trading system into which all but a few countries have been irresistibly drawn. Students of Economics owe a deep debt of gratitude to Mr. Folke Hilgerdt and his associates of the League of Nations for giving them a concrete statistical picture of the growth of the multilateral trading system in *The Network of World Trade* published by the League of Nations in 1942. India naturally fills a small space in the wide canvas, but the perspective which the present writer has gained from a study of this remarkable work has enabled him to draw a magnified picture of India's trade relations with the rest of the world, and it is hoped that the new setting in which our trading

relations are presented in this chapter will help the reader to understand the problem of the reconstruction of India's foreign trade and the re-orientation of her commercial policy.

For convenience of analysis it is necessary to summarize the most significant conclusions reached by Mr. Hilgerdt and his colleagues. They have arranged almost all countries in the order of the direction of their balances of trade, so that each country had an import balance from practically all the countries that preceded it in the list and an export balance from practically all the countries that succeeded it. At the beginning of the list we find the tropical debtor countries (including India) with export balances in almost all directions, and at the other end we find the creditor countries with import balances from practically all countries, the United Kingdom forming the terminal point. Between these two extremes, viz., the tropical countries and the United Kingdom, different countries arrange themselves 'in an order that is not necessarily determined by the absolute or relative magnitude of their total balance of trade'. The final list emerges as follows:—(1) Tropics; (2) The United States; (3) Regions of Recent Settlement in the Temperate Belt (including the British Dominions, the Argentine, Uruguay and Paraguay); (4) Germany; (5) Europe except Germany and U.K; (6) The United Kingdom.[1] These ramifications of multilateral trade as a world-wide system spread during the last few decades of the 19th century. From the beginning it was linked up with the transfer of the yield of British investments in the undeveloped areas of the Tropics. Initially it was 'extensive' expansion of investment (springing from territorial expansion and population growth) originating in the United Kingdom which activated the economies of the tropics as well as her own economy. Since she was an activating centre and a centre of economic progress, the stimulus of her buying power, of her improvements in the

1. The terminal point and the transfer routes through which it is reached can be easily seen if, taking the 'Tropics' as the starting point, the countries set out in the list are arranged clockwise. The reader is referred to the chart on p. 78 of the *Network of World Trade* which presents an excellent synoptic view of the pattern of multilateral trade.

technology of production and transportation and of her capital, and, above all, as Condliffe says, 'the economic power and authority of a great trading country with naval power not far in background', set the pace of expansion of world trade. At first her exchange with debtor countries was bilateral. As British overseas investments increased and the income from investments began to exceed largely new British capital exports an import balance arose in relation to the tropical debtor countries. We have already called the attention of the reader to this particular phase of British capitalistic enterprise in connexion with India's foreign trade in Chapter I. But it was up to a point that tropical economies could effectively serve as complementary economies. With a rising standard of life Great Britain's requirements of imports could not be entirely met by the exports of comparatively static tropical economies. Economic development in Europe and the United States which had started in the 'seventies made it possible for Great Britain to derive an increasing proportion of her imports from these countries. She became a principal market for the products of the United States and for French fashion textile products, Danish bacon and butter, Swedish paper and timber, etc. But so long as economic development in Europe and the United States was exclusively in the field of agrarian or primary production, these regions absorbed traditional British manufactured goods (such as textiles and apparel which formed 60 per cent of the total value of British exports in 1860). But from the late 'seventies or early 'eighties direct competition as well as industrial protection maintained a restrictive pressure on British exports to these regions. Hence the import surplus received by Great Britain from both the U.S.A. and Europe increased rapidly during the last three decades of the 19th century. At the same time the import surplus received from tropical debtor countries declined and was subsequently converted into an export surplus, for Great Britain's export industries had adjusted themselves to the requirements of tropical countries during the period of capital exports to these countries. These shifts in trade balances occurred in spite of the facts (1) that British investments in Europe were not large; (2) that interest and dividend receipts from the U.S.A. did not change materially

during this period; and (3) that the annual commitments of the tropical countries on account of interest and services increased. At the beginning Great Britain as the centre of entrepôt trade exchanged European goods against the products of other continents. But gradually with the development of their merchant marines, the countries of continental Europe began to obtain an increasing share of their supplies of tropical products by direct imports. Thus the development of trade balances conformed to a trading system by which the United States and continental Europe financed their increasing purchases of primary goods by net exports to Great Britain, and Great Britain obtained the amount by which the yield of her investments outside Europe and her income from services exceeded net capital exports, in the form of goods imported from continental Europe and the U.S.A. At the same time the demand for primary goods which the U.S.A. and countries of Continental Europe exercised through their export surplus to Great Britain was responsible for counteracting the tendency of falling prices of primary products. Up to this stage trade had evolved from a bilateral to a triangular pattern. Eventually the multilateral features of the trade appeared as 'Regions of Recent Settlement in the Temperate Belt' came into the picture and as the U.S.A. and Germany emerged as advanced manufacturing nations. The 'Regions of Recent Settlement in the Temperate Belt' are sparsely populated 'whitemen's countries', generally rich in mineral wealth, which have shown great potentialities of agricultural development and, latterly, the development of mining and manufacturing industries. The U.S.A. did not require to import much from them, for in fact she is herself a 'recently settled' country with similar natural conditions; but she could supply them with transportation equipment and capital goods. Thus she came to have an export surplus in relation to these countries; so did the tropical countries which sold primary goods. The Countries of Recent Settlement, however, were able to pay for the net import from the U.S.A. and the tropics by a net export of foodstuffs and raw materials to Germany and other industrial countries of Europe. From the late 'nineties the improvement of refrigeration enabled the Argentine, Australia and New Zealand to send fresh meat

across the tropical belt to Europe, and Canada also became an important exporter of wheat to Europe. The losses of the United States in the exports of foodstuffs to Europe as the result of this new international competition were, however, more than offset by gains in the exports of manufactured products. While the Countries of Recent Settlement occupied an intermediate position between the U.S.A. and Europe, Germany, which emerged as a great manufacturing nation and needed foodstuffs and raw materials from the tropical as well as temperate countries, paid for her net imports from overseas by a net export to the rest of Europe. The rest of Europe, which was near the terminal point in the transfer routes, financed its net imports from Germany and overseas in part by interest and dividends on overseas investment and in part by net exports to the United Kingdom.

If we follow the logic of these developments a little more diligently we at once begin to realize that the multilateral trading system had important monetary, financial and economic aspects. As Mr. Hilgerdt explains, 'uniform valuation in different markets of each currency is a primary condition for international monetary equilibrium; such valuation is possible only if each currency can be freely turned into any other currency at non-discriminatory rates of exchange; but such currency operations are possible only through the multilateral exchange of goods, services, etc. of which they form counterpart'. Under the system of international gold standard the stability of exchange rates was maintained through arbitrage operations which overcame local differences in the supply of, and the demand for, each currency. But currency arbitrage could work only if there was multilateral, non-discriminatory conversion of currencies which presupposes a multilateral trading system. The financial aspects of this system are no less important. The development of the economic resources of the world by means of capital migrating from the wealthier nations was one of the chief causes of the rapid and general economic progress witnessed in the period 1870-1913. If the transfer and service of international loans had permanently diverted trade into bilateral channels, the expansion of production and employment would have been very limited indeed. Equilibrium in the balance of

payments in this case would have required the creditor countries either to try to increase their imports from the debtor countries or to reduce their exports to them. But the optimum capacity of the creditor countries to absorb primary goods would have been in any case limited, whereas the multilateral trading system opened up a world market for primary products in which prices were maintained in spite of expanding production.[2] On the other hand, the creditor countries which had adapted their export industries to the requirements of the tropics could scarcely think of curtailing their exports to the tropical countries. Indeed it was the multilateral trading system which enabled the former actually to expand their exports to the latter. From the broad economic point of view the multilateral trading system also activated the economies of countries lying along the transfer routes which were, by and large, neither debtors nor creditors, and gave them commercial access to raw materials. It is quite easy to see that but for multilateral trade commercial access to raw materials (and industrial development) would have been largely problematical for Germany and other countries of continental Europe which required the primary products of the tropics and the temperate belt, and for 'Countries of Recent Settlement' which needed tropical raw materials.

The multilateral trading system and the world-wide settlement of payments broke down after 1928 for various reasons a full discussion of which is beyond the scope of this book. But three principal effects of the blocking of the channels of multilateral trade have to be briefly noted, for they have an important bearing upon the re-orientation of India's trade relations during the inter-war period. In the first place, since a country normally tended to have an export surplus in relation to certain countries and a net import in other directions, in the absence of a multilateral settlement of balances, she had in extreme cases to relieve the pressure upon her currency by means of exchange control in the sense of maintaining different rates of exchange for different types

2. For example, two-thirds of the rubber exported by the Netherlands Indies and British Malaya went to the U.S.A.

of transactions or even for trade with different countries. Protection, quota restrictions and import prohibitions were also employed to cut down imports from countries having an export surplus to her. In many cases payments agreements, clearing agreements and barter agreements were used as instruments of bilateral adjustment of the balance of international payments. In the second place, the breakdown of the multiliateral trading system created a real problem of commercial access to raw materials for Germany and other countries of Continental Europe, which, having no colonies, were not in a position to erect a protective wall of empire preferences. Lastly, the trade between creditor and debtor countries began to be diverted to bilateral channels, because it was no longer possible to collect interest, dividends and payments in respect of services as well as amortization, in the form of goods imported from Europe and the U.S.A. The economic consequences were disastrous for the debtor countries of the tropics. It was no longer possible for the creditor countries to absorb a substantial share of the output of primary goods normally exported by these countries. Thus disorganization of the free world market accentuated the fall in the prices of primary products, thus causing a serious decline in the national incomes of 'primary countries'. The yield of investments and services could only be transferred by reducing the net export of the creditor countries and, if necessary, by converting it into a net import. But such a readjustment of trade balance was an equally difficult process for the creditor countries. They were disposed to sacrifice their financial interests (involved in the transfer of the yield of their overseas investments) to the economic (i.e. maintaining their exports to debtor countries). Thus owing to transfer difficulty the transferable yield of investments declined, and direct investment of capital by wealthier nations in the economic development of underdeveloped areas was seriously arrested. At the same time the economics of the debtor countris were exposed to intolerable strains which crippled their productive power and caused general impoverishment. Many countries like India precariously maintained equilibrium in their balance of payments by heavy export of gold.

We shall now endeavour to present a magnified picture of India's position in the multilateral trading system and the vital changes in her commercial relations with the rest of the world during the period of the slow disintegration of the world-wide system of settlement of international payments. By 1913-14 multilateral trade with all its ramifications had attained its optimum development. India's position at that time in the framework of world trade is clearly indicated by the following statistical table.

1913-14

INDIA'S EXPORTS, IMPORTS AND BALANCE OF TRADE
(in crores of rupees)

	Exports	*Imports*	*Balance*
The United Kingdom ..	58	117	— 59
Other countries of the British Empire ..	36	11	+ 25
Total British Empire ..	94	128	— 34
Europe ..	85	30	+ 55
U.S.A. ..	22	5	+ 17
Japan ..	23	5	+ 18
Other foreign countries ..	25	15	+ 10
Total foreign countries ..	155	55	+100
GRAND TOTAL ..	249	183	+ 66

As already explained, during the initial period of capital exports to the debtor countries of the tropics, the United Kingdom had an import balance in relation to these countries. Gradually during the last three decades of the 19th century her import surplus received from Europe and the United States increased, while her import surplus from countries like India declined. Through the development of multilateral trade it was possible for India to absorb more of British goods and yet find an increasing outlet for her primary products in Europe and the U.S.A. Subsequently from about 1875 onwards, heavy Indian import balances with the United Kingdom made their appearance as the logical culmination of the existing economic tendencies. Thus during the years

preceding the last Great War India used to have a passive balance in relation to the United Kingdom. In 1913-14 the balance of trade in relation to the United Kingdom was unfavourable to the extent of Rs. 59 crores. This unfavourable balance used to be settled by the usual mechanism of triangular trade; for example, Indian exports to the U.S.A. were paid for by sterling drafts on London. As the statistical table clearly shows, owing to the world-wide consumption of her export products, India used to have export surpluses in her trade with the United States, Continental Europe, Japan and various other parts of the world. These export surpluses (Rs. 125 crores in 1913-14) not only financed net imports from the United Kingdom (Rs. 59 crores in 1913-14), but also liquidated considerable amounts due each year to the United Kingdom for services rendered and for the excess of debt service and dividends over new capital imports.

During the inter-war period fundamental changes occurred in the movement of the trade balances and the manner in which they had to be readjusted somehow to ensure equilibrium in the balance of payments. The comparative tables given on page 22 will help us to analyse the underlying changes.

These tables reveal two striking trends, which, as we shall presently see, were related to each other. First, India's pre-war import balance received from the United Kingdom, which had been Rs. 59 crores in 1913-14, was progressively reduced during the inter-war period till it was Rs. 5 crores in 1934-35 and Rs. 2 crores in 1935-36. In 1936-37 the import balance was converted into an export balance received by the United Kingdom from India which reached the record figure of Rs. 16 crores. In 1937-38 the corresponding figure was Rs. 12 crores. The second trend which is no less obvious is the heavy reduction of India's export surplus in the trade with 'foreign countries'. This surplus which had been as much as Rs. 100 crores in 1913-14 was reduced to Rs. 17 crores in 1934-35. There was a slight increase to Rs. 18 crores in 1935-36 and a substantial increase to Rs. 43 crores in 1936-37, but in the year preceding the outbreak of the recent war it was as low as Rs. 11 crores. The causes underlying these tendencies are not far to seek. In the

Exports, Imports and Balance of Trade (in Crores of Rupees)

	1934-35			1935-36			1936-37			1937-38		
	Exports	*Imports*	*Balance*	*Exports*	*Imports*	*Balance*	*Exports*	*Imports*	*Balance*	*Exports*	*Imports*	*Balance*
United Kingdom ..	49	54	— 5	50	52	— 2	60	44	+16	64	52	+12
Burma ..	..	..	..	..	..	..	11	27	—16	11	26	—15
Other parts of the British Empire ..	22	11	+11	23	13	+10	20	13	+ 7	24	17	+ 7
Total British Empire ..	71	65	+ 6	73	65	+ 8	91	84	+ 7	99	95	+ 4
Europe ..	30	25	+ 5	..	..	..	39	23	+16	36	32	+ 4
U.S.A. ..	13	8	+ 5	16	9	+ 7	19	7	+13	19	13	+ 6
Japan ..	24	21	+ 3	22	22	..	28	19	+ 9	19	22	— 3
Other foreign countries ..	17	13	+ 4	49	38	+11	15	9	+ 6	16	12	+ 4
Total foreign countries ..	84	67	+17	87	69	+18	101	58	+43	90	79	+11
GRAND TOTAL ..	155	132	+23	160	134	+26	192	142	+50	189	174	+15

'seventies Great Britain's share in India's imports had been more than 80%. But with the gradual industrial development in Europe and America and latterly in Japan, her share went on declining. After the last Great War the British cotton textile industry lost ground in the Indian market to Japan and the domestic cotton industry, while the United States and continental Europe became important sources of supply of capital goods. Naturally India's heavy adverse balance of trade in relation to the United Kingdom was gradually declining. But these changes were slow in comparison with the abrupt shifts in the trade balances which occurred in the 'thirties. As soon as the multilateral trading system disintegrated and many countries were unable to pay for their previously large import surpluses from India by triangular trade, they either tried to increase their sales to India or turned to other alternative sources of supply in countries which were anxious to buy their goods. India was, therefore, unable to pay for her net imports from the United Kingdom which declined very heavily in consequence. In 1929-30, the last pre-depression year, India's adverse balance in relation to the United Kingdom was Rs. 36 crores, as compared to Rs. 59 crores in 1913-14. The sensational fall in imports during the first three years of the depression reduced the adverse balance still further to Rs. 11 crores in 1932-33. The Ottawa Agreement gave some stimulus to India's exports to the United Kingdom without inducing a commensurate increase in her imports from the United Kingdom.[3] Eventually the values of India's imports and exports exactly balanced in 1933-34. Thereafter the yield of services and investments had to be financed by means of an export surplus which, as we have seen, first appeared in 1936-37. The second trend noted

3. The increased tariff preferences which India granted to the United Kingdom did not improve the latter's position in the Indian market. On the contrary her share in the total Indian imports decreased from 45 per cent in 1928 to 36 per cent in 1938. As our analysis has shown, far more powerful economic forces were at work than could be controlled by manipulation of the Indian tariff.

above seems to have been the counterpart of the first. Before the depression 'foreign countries' sold more and more of non-durable consumer's goods, metal products and capital goods in the Indian market and thus reduced their adverse balance of trade in relation to India. But with the onset of the depression their demand for primary goods exported by India fell off, and the transfer difficulty involved in financing net imports from India reinforced the collapse of demand for India's export products in these countries. In these circumstances the export surpluses received from them by India declined very considerably in the worst years of the depression. While we reflect on these shifts in the trade balances two significant conclusions suggest themselves. First, if we compare the position in 1937-38 with that in 1913-14, the disappearance of India's net import from the United Kingdom taken in conjunction with her net export to the United Kingdom did not suffice to compensate for the decline in India's net export to 'foreign countries'. This was, among other things, due to the contraction of the free world market caused as much by the economic depression as by the breakdown of the multilateral trading system. Second, India's trade with the United Kingdom which came to be definitely characterized by an export surplus (in relation to the United Kingdom) once more conformed to a pattern of bilateral exchange between a creditor country like the United Kingdom and a debtor country like India, which had existed before 1875. One is tempted to conclude that this was only natural because Indian trade was sought to be diverted to bilateral channels by the system of empire preferences while the ramifications of the multilateral trading system were being fast swept away.

The inter-war period witnessed a change in the composition of India's foreign trade which, although not very pronounced, indicated a significant trend of economic development. The figures in the following statistical table, which have been taken from table 9 on page 28 of the *Network of World Trade,* illustrate this significant change.

PERCENTAGE COMPOSITION OF THE TRADE OF INDIA AND BURMA

Groups of Commodities	*Imports*			*Exports*		
	1928	1935	1937	1928	1935	1937
Foodstuffs and live animals ..	14	10	12	21	24	26
Materials, raw or partly manufactured ..	11	16	21	53	52	51
Manufactured articles ..	75	74	67	26	24	23

Experience shows that when countries in a relatively *early* stage of economic development make industrial progress imports of raw materials and partly manufactured goods increase, while exports of crude materials and foodstuffs decrease, in *relative* importance. At the same time there is a decrease in the relative significance of manufactured imports and an increase in the relative importance of manufactured exports. When industrial development is stimulated by tariff protection such a shift in the composition of the import trade becomes more pronounced. These tendencies are broadly reflected in the statistics tabulated above. Imports of raw materials and partly manufactured goods which formed 11 p.c. of imports in 1928, were 16 p.c. of imports in 1935 and 21 p.c. in 1937. At the same time there was a decline in the exports of this category of goods from 53 p.c. in 1928 to 51 p.c. in 1937. The decrease in exports was mainly due to the economic depression and the breakdown of the multilateral trading system. But the more pronounced increase in imports can be explained only in terms of industrial development which occurred in India during the period of depression as the result of protection afforded by a high revenue tariff in general and tariff protection to selected industries in particular. Sir George Schuster, Finance Member of the Governor-General's Executive Council, said in his budget speech of 1935: 'in the last two years, partly aided by the high level of our

revenue duties there has been a general and marked development of minor industries in India. Indian industries were manufacturing a wide range of articles, such as electric lamps, water-softening plant, cooking stoves, asbestos cement products, paints and enamels—to mention only a few instances'. The high level of duties had induced the leading United Kingdom groups manufacturing cigarettes, soap, rubber tyres, asbestos products, metal boxes, electric lamps, aluminium ware, biscuits and many other items to supply the local market from their Indian factories. Imperial Chemical Industries, Ltd. started an Indian manufacturing company to produce soda ash, caustic soda and chlorine, while the Batas were manufacturing shoes. Indian concerns were also interesting themselves in the manufacture of heavy chemicals. Indian paper, cement, sugar, matches, agricultural implements, electric fans, glassware, copper sheets, certain types of electrical cables, pharmaceutical products, medical supplies, disinfectants, etc., were replacing imported goods to a certain extent. The Indian iron and steel industry had gained a firm footing in the Indian market. With the exception of locomotives, wheels and axles and a few specialities in respect of rolling stock and permanent way equipment, India was producing at this time all the railway equipment, including permanent way material, wagons, carriage stock and bridgework that she required. The decrease in the relative importance of imports of manufactured goods (indicated by the fall in the proportion of such goods to total imports from 75 per cent in 1928 to 67 per cent in 1938) reflects the effects of industrialization, but these effects can be seen to best advantage when we observe the change in the relative proportions of (a) finished goods and (b) machinery and mill stores respectively to total imports. A remarkable fact to which the figures in the statistical table unmistakably testify is the importance of India's export trade in manufactured articles. Manufactured products accounted for 26 per cent of India's exports in 1928, 24 per cent in 1935 and 23 per cent in 1938. When we remember that during this period the contracting free market for export products was characterized by cut-throat international competition, the rela-

tive importance of manufactured products in India's exports does not seem to have diminished as much as one would expect. This interesting aspect of our export trade in manufactured goods merits careful enquiry with special reference to the composition and destination of this trade. Such an enquiry is handicapped by scarcity of data, but such facts as the present writer has been able to glean from the reports of His Majesty's Trade Commissioners will be presented in a different context in a subsequent part of this chapter.

It would be instructive to pass from the general to the particular and to fill in the broad outline which has been sketched out against the background of world trade with a somewhat detailed account of the character and trend of India's foreign trade during the inter-war period. What follows is a verification of the thesis which has been formulated in terms of general conclusions, and the treatment will be illustrative and not exhaustive. We shall pass in rapid review India's trade relations with the major trade blocks or countries in the following order:—(1) Europe (excluding the United Kingdom), the United States of America and Japan (*countries outside the British Empire*) which collectively accounted for 40 per cent of imports and 41 per cent of exports of India, Burma and Ceylon in 1938; (2) Empire countries, excluding the United Kingdom and *including the Dominions and Colonies;* and (3) the United Kingdom (which accounted for 36 per cent of imports and 29 per cent of exports of India, Burma and Ceylon in 1938).

EUROPE

(Excluding the United Kingdom)

As we have already shown, the sudden disintegration of the multilateral trading system made it difficult for countries of continental Europe to pay for their previously large import surpluses from India by triangular trade. Hence they either tried to increase their sales to India or turned to other alternative sources of supplies in countries which were

anxious to buy their goods. Increased sales of continental goods in India served to reduce India's net export to these countries, but the net export did not entirely disappear in spite of serious transfer difficulties, the absence of bilateral clearing agreements between these countries and India (which subjected Indian trade to import and exchange restrictions) and the trade-constricting effects of the system of empire preferences. The following table would be of interest to readers in this connexion.

INDIA'S BALANCE OF TRADE WITH COUNTRIES OF CONTINENTAL EUROPE

Countries	1936	1937	*Expressed in millions*
Germany ..	+19·4	+20·9	R.M.
Austria ..	+ 5·6	+ 5·2	Shillings
France ..	+ 713	+1043	Francs
Belgium ..	+ 246	+ 515	Belgian Francs
Holland ..	+ 9·9	+21·9	Florins
Czechoslovakia ..	+ 224	+ 309	Crowns
Poland ..	+27·3	+34·1	Zlotys
Switzerland ..	+ 1·3	− 1·2	Swiss Francs
Sweden ..	+ 4·6	+ 6·5	Swedish Kronen
Norway ..	+ 4·7	+ 5·1	Norwegian Kronen
Denmark ..	− 1·7	− 2·2	Danish Kronen
Finland ..	+12·8	+39·9	Finnish marks
Latvia ..	+·184	+·404	Lats
Lithuania	+1·859	+3·561	Litas

Stockpiling and the rearmament boom in anticipation of the recent war were no doubt responsible for keeping up the demand for Indian export products. The striking increase in the demand for India's export products every-

where in Europe in 1937, which caused an increase in India's net export in 1937 as compared to 1936, cannot have any other explanation. It must be pointed out that the increase in the net export was the result of a proportionately greater increase in Indian imports into a particular country than in the exports of that country to India. Where the balance moved against India the reason was to be found not in any decline in imports from India, but in a proportionately greater rise in exports of a particular country to India. During the inter-war period the disorganization of international trade which increased the pressure upon the balances of payments of the countries of continental Europe encouraged protectionism by which they could reduce the amount of such imports as could be produced at home even at a higher real cost. Imports of foodstuffs could somehow be replaced by increased domestic production in every country. But increasing self-sufficiency could not be attained in respect of industrial raw materials for two reasons: (1) their production is often too specialized to permit of stimulation of domestic production by tariff protection; (2) the higher domestic cost of raw materials (which protection implied) was bound to undermine the competitive position of their manufacturing industries in the foreign markets. Hence during this period the demand for the tropical raw materials and foodstuffs supplied by India did not prove to be as adaptable as one would expect in the circumstances, although it must be borne in mind that the peculiar difficulties in the way of obtaining natural raw materials (in spite of over-production and falling prices) stimulated the search for synthetic raw materials as substitutes and encouraged their production on a commercial scale.

ITALY

The character of India's trade with Italy during the early years of the depression is indicated by the following table representing the total values of principal exports and imports for the year 1932.

IMPORTS AND EXPORTS (VALUES)

(in millions of Lire)

Principal imports from India		*Principal exports to India*	
Colza and Rapeseed	54·4	Rayon, waste and tissues	39·7
Raw cotton	52·9	Woollen piece-goods and manufactures	35·3
Raw Jute	49·7	Cotton piece-goods and manufactures	20·0
Groundnuts	40·8	Silk, waste, yarns and tissues	13·9
Raw rubber	14·4	Motor tyres and tubes	12·5
Copra	13·6		
Raw hides	11·8		
Linseed	8·2		

Raw cotton imported from India in 1930 amounted to 24 per cent of total imports, as against 60 per cent supplied by the U.S.A. India was one of the principal suppliers of hides and skins along with Argentina, Australia, British South Africa and France. Nearly 80 per cent of coconut oil came from India. Peanuts were imported principally from India. Copra was supplied by India, the only other competitor being Zanzibar. India supplied 12,500 tons out of about 19,000 tons of raw rubber. On the export side India was an important purchaser of rayon and artificial silk tissues. In 1932 India was the biggest purchaser of rayon next to Germany and absorbed 2·8 million kilos of rayon. Next to the United Kingdom India was the biggest purchaser of artificial silk tissues and bought 208,261 kilos in 1932.

After the lifting of the economic sanctions on 15 July 1936 Italy entered into agreements for quotas and payments which guaranteed balanced trade and settlement of arrears wherever they had existed. By 1937-38 as many as 90 trade and payments agreements had been concluded with various countries. The flow of Italian trade along treaty channels rapidly increased, preference being given to imports from countries with which clearing agreements were in force. But since the high level of industrial production in spite of the economic depression increased the purchases of raw materials

all of which could not be obtained through treaty channels, the necessary supplies of essential raw materials had to be obtained from countries which were not inclined to enter into bilateral clearing agreements with Italy. India had no clearing agreement with Italy and, with the banning of private barter, imports from India were subject to rigid official control. Yet Indian exports did not lose the Italian market as much as they should have in the circumstances. The total value of imports from India was 353·4 million Lire in 1934, 230 million Lire in 1935, 138 million Lire in 1936 and 483 million Lire in 1938. India's net export to Italy which was 88·4 million Lire in 1936 was as much as 344·9 million Lire in 1938.

GREECE

The Anglo-Greek commercial treaty signed in July 1926 contained a 'modus vivendi' arrangement by which India got a most-favoured-nation treatment pending the conclusion of negotiations for formal treaties. From 1932 onwards, however, Greece concluded clearing agreements with a number of countries, and countries such as the United Kingdom which had neither clearing agreements with Greece nor unfavourable balances of trade with her were heavily penalized by import restrictions. But although India did not have a clearing agreement with Greece and had a favourable balance of trade with her, yet her trade was not so heavily penalized as one would expect. Indian exports to Greece in 1937 consisted of textile materials and other essential industrial raw materials which could not be replaced, the only foodstuffs imported being rice and coconuts. India exported to Greece rice, linseed, coconuts, raw hides, tin, colours and products for dyeing and tanning; vegetable and animal tinctures; rubber and gutta percha; hemp; jute, linen hemp and jute yarns; cord and twine; linen, hemp and jute goods; jute bags, ginned cotton, cotton yarns, and wool and hair. In linseed India contributed over 97 per cent in 1937 as against 99 per cent in 1936. In copra India's share was 50 per cent in 1937 as against 38 per cent in 1936. In groundnuts India's share increased from 91 per cent in 1936 to 98 per cent in 1937. India's share in

imports of raw cotton fell from 47 per cent in 1936 to 42 per cent in 1937. In jute bags India's share amounted to 58 per cent in 1937 against 44 per cent in 1936.

YUGOSLAVIA

With the object of correcting the adverse balance of trade with some of the non-clearing countries, the Yugoslav Government decided in 1936 to introduce a system of controlling imports from these countries. A list of commodities was published the importation of which from non-clearing countries was subject to the granting of a licence by an import committee formed at the National Bank. Import licences were granted in respect of goods contained in the list up to certain prescribed values depending on the Yugoslav exports to a certain country. These rigid restrictions did not prevent India from increasing her share in Yugoslavia's import trade from 1·89 per cent in 1936 to 2·25 per cent in 1937, and her net export to this country from 66·4 million Dinars in 1936 to 104·7 million Dinars in 1937. Raw cotton, rice, jute and oilseeds constituted the bulk of India's exports to Yugoslavia.

BELGIUM

India's exports to Belgium before the present war consisted of (1) *animal products* (wool and bones); (2) *vegetable products* (rice, coffee, tea, fruits for tanning, decorticated groundnuts, rapeseed, mustard seed, sun-flower seed, copra, hemp, cotton, cotton waste, jute, coir, gum, rubber, alfa grass); (3) *minerals* (manganese, zinc, wolfram); and (4) *fodder* (groundnut cakes, copra cakes). Jute sacks were the only manufactured commodity exported to Belgium. Belgium's exports to India (in 1925) consisted of special steel in bars, iron in special sections, sheet iron, nails, needles, hooks, window glass, crystal glass, table and ornamental glass, glazed or enamelled paper and board, paper and board, earthenware goods, etc. The total value of India's exports increased from 636·8 million francs in 1936 to 965·6 millions in 1937. Belgium's exports to India showed a somewhat smaller increase from 390·6 million francs to 448·4 millions.

In 1937 Belgian exports to India, in spite of an absolute increase, represented only 46·4 per cent of Belgium's imports from India, whereas in 1936 the proportion had been 61·3 per cent. In 1936 India was the ninth largest supplier to Belgium; in 1937 she moved up a place and became the eighth largest supplier. In fact we observe a general upward trend in the volume of India's staple exports like jute, cotton, coir, rapeseed and manganese between 1929 and 1937. India's net exports to Belgium increased from 246 million francs in 1936 to 518 millions in 1937.

GERMANY

The trend of India's trade with Germany since 1928 is illustrated by the following table :—

Year	*Imports from India*	*Variation*	*Exports from India*	*Variation*	*Balance + or —*
	(Value in R.M. millions)				
1928	711·4	..	222·9	..	—488·5
1929	623·7	— 87·7	220·4	— 2·5	—403·3
1930	428·6	—195·1	190·0	—30·4	—238·6
1931	280·5	—148·1	157·5	—32·5	—123·0
1932	158·8	—121·7	109·3	—48·2	— 49·5
1933	153·9	— 4·9	86·8	—22·5	— 67·1
1934	134·7	— 19·2	94·4	+ 7·6	— 40·3
1935	121·3	— 13·4	111·3	+16·9	— 10·0
1936	142·0	+ 20·7	122·6	+11·3	— 19·4
1937	168·5	+ 26·5	147·6	+25·0	— 20·9

After the last war Germany's trade with India revived to an unexpected degree. But among other things the serious transfer problem created by one-sided reparation payments gave rise to serious disequilibrium in Germany's balance of

payments which could only be corrected by drastic measures to secure as far as possible a structure of balanced trade. It will be observed that in 1928 the total value of Indian imports into Germany exceeded the total value of German exports to India by as much as 488·5 million R.M. Such a large net import perhaps could not be sustained by Germany's balance of payments position. From 1928 to 1935 there was a progressive reduction in the total value of Indian imports into Germany. There was also a progressive decline in the total value of German exports to India. But it will be noticed that there was a greater fall in the value of Indian exports to Germany than in the value of German exports to India. There was consequently a drastic reduction in India's net export to Germany which reached the lowest level (49·5 million R.M.) in 1932. The value of Indian exports to Germany increased during 1936 and 1937, while German exports to India had begun to show an upward trend earlier in 1934. But with the exception of an increase in India's net export (Germany's passive balance) in 1933, India's net export to Germany maintained an uninterrupted fall till the outbreak of the recent war. During the inter-war period Germany made a virtue of the necessity of bilateral clearing and bilateral adjustment of trade, and took drastic steps to reduce the volume of imports from countries which refused to have clearing agreements with her and yet had an active balance of trade with her. Under the New Plan of September 1934 an elaborate scheme was devised for the control of imports with a view to limiting them to such quantities as could be paid for by exports or from the proceeds of the sale of exports. Imports were sought to be limited to such raw materials as were indispensable for the execution of the national socialistic plan of creating domestic employment and rearmament and for the stimulation of export trade. By the end of 1935 as many as 31 countries had come to some kind of payments or clearing agreement with Germany. 60 per cent of the German foreign trade came to be regulated by these agreements, and the supply of free foreign exchange amounted to only 20 per cent of the total value of German exports in 1935. Since Germany began to buy as much as possible from countries with whom she had an active balance of trade and reduced

purchases from countries with whom she had a passive balance of trade, countries producing raw materials, such as Canada, Australia and New Zealand, which had an active balance of trade with Germany, found their exports to Germany drastically reduced. But India which was in the same position fared much better. In fact the German market for Indian products instead of contracting still further began to expand after 1935, although it seems as if Germany definitely aimed at a progressive reduction in India's active balance of trade with her. There are two reasons why India fared better than Australia, Canada or New Zealand. First, although India was the only other country, besides the U.S.A., with which Germany had no trade agreement, yet the reason why imports from India were maintained was that India exported commodities of which Germany was in great need. The main categories of Indian exports to Germany were (1) foodstuffs (groundnuts and tea); (2) raw materials (cotton, flax, hemp, jute, hides and skins, rubber, shellac, oilfruits for technical purposes, manganese, copper ore, chrome and nickel ore); (3) half-finished goods (jute manufactures); and (4) finished manufacture (leather). The principal commodities exported, in their order of importance, were groundnuts, jute, cotton, hides and skins and tea. Imports of such commodities could not be replaced by domestic production. But Germany concentrated on the manufacture of industrially produced substitute raw materials such as rayon and staple fibres, which were designed to replace wool, silk and cotton. Imports of hemp from India were materially affected in consequence. Germany was also successful in the domestic production of flax. Secondly, India was able to maintain her exports to Germany largely through barter and compensatory business. In 1935-36 Germany's attempts to conclude a compensation or barter agreement with the Government of India failed. The Government of India explained that the award of state contracts was governed by the rule that stores must be purchased in the cheapest market, and in this matter Germany enjoyed equal chances and was actually obtaining contracts for locomotives, boilers, etc. But in order to economize foreign exchange accruing to Germany on account of her exports to India, she concluded private compensation agree-

ments with certain Indian States and powerful exporting firms in British India. Examples of this type of trade included the exchange of Mysore sandalwood oil for steel plant, the exchange of Travancore copra and pepper for electrical generating plant and pipe-line, the barter by Ahmedabad mill-owners of raw cotton against textile machinery, and an arrangement by which a prominent producer firm undertook to barter miscellaneous produce for German plant and motor vehicles. In February 1937, however, a decree of the German Government banned private compensation deals. But it is very probable that the increase in German exports to India and Indian exports to Germany which characterized the trade between the two countries after 1935 was due to private barter or compensation agreements.

FRANCE

Before the last Great War the French protective tariff afforded protection to agriculture in metropolitan France as well as in the colonial empire in which the French protective tariff was introduced *en bloc*. As a supplier of raw materials and foodstuffs India did not enjoy most-favoured-nation treatment, and Indian products imported into France were subject to the *General*, and not the *Minimum*, scale of tariff. India had the advantage of the minimum tariff in respect of 'Colonial Produce' which was defined to include only tea, coffee, spices, sugar and tobacco. But sugar and tobacco were excluded from the operation of the minimum scale. In respect of other articles India was on the same footing as other agricultural countries except China. Indian products were penalized in the French market whenever they competed with the products of French colonies. In fact French imperial preference adversely affected the Indian market for rice and pepper. Indian rice paid a duty of 3 to 8 francs per 100 Kilogrammes, while Indo-Chinese rice was admitted free of duty. Indian pepper paid a duty of 104 francs per 100 Kilogrammes in excess of what was paid on Indo-Chinese pepper. As regards other food products, Tunis and Algeria supplied practically the entire French demand for barley, but wheat, coffee and tea were imported from outside the Empire. The

situation was, however, different in the case of agricultural raw materials required for industry. In spite of the fact that groundnuts were grown in French West Africa, for two-thirds of her requirements of groundnuts France depended on India. In respect of jute, sesamum, cotton, copra and rubber imperial preference was no obstacle in the way of Indian exports. France was also India's chief market for raw skins.

The trend of India's trade with France during the inter-war period is indicated by the following statistics:—

TOTAL VALUES IN MILLION FRANCS

	Imports from India	*Exports to India*	*Balance + or —*
1923	.. 1718	281	—1437
1924	.. 2216	342	—1874
1925	.. 2552	387	—2165
1928	.. 2653	506	—2147
1929	.. 2758	450	—2308
1930	.. 2103	339	—1864
1931	.. 1163	238	— 925
1932	.. 790	166	— 624
1933	.. 792	112	— 680
1936	.. 780	67	— 713
1937	.. 1162	119	—1043

The trend of trade clearly shows that before the economic depression of the 'thirties in spite of the French imperial preference and the absence of most-favoured-nation treatment India had a very large active balance of trade with France which progressively increased between 1923 and 1929. The economic depression and the disintegration of multilateral trade caused a drastic reduction in India's net export to France, but it began to increase again after 1932 and reached 1043 million francs in 1937. The absolutely large passive balance which France normally had in her trade with India depended upon the character of the demand for the commodi-

ties mutually exchanged. French imports from India consisted almost entirely of raw materials for industry and were more diversified in character than those from other parts of the British Empire. The leading items in 1928-30 were (1) oleaginous seeds and fruits (894 million francs); (2) raw cotton (427 million francs); (3) jute (366 million francs); (4) crude rubber and gutta percha (219 million francs); (5) tin (112 million francs); (6) ores (89 million francs); (7) raw hides and pelts (63 million francs). Next to Germany France was the biggest importer of jute on the continent. Before the recent war France was the only important importer of Indian hemp. France along with Germany was the biggest consumer of Indian hides and skins and manganese. But during the period of economic depression India permanently lost a substantial part of her market for groundnuts in France owing to Russian competition in rapeseed, Argentine competition in linseed and Brazilian competition in castor seed. French exports to India consisted of 'high-income' luxury goods the demand for which in India is bound to be small in volume even in the best of times and could not but show a heavy decrease (as the statistics clearly show) during the period of depression. For example, in 1928-30 the leading items of French exports to India were (1) wines and spirits (49·6 million francs); (2) pearls (41 million francs); (3) woollen fabrics (40·8 million francs); (4) silk fabrics; (5) tools and metal wares; (6) perfumes and soaps; and (7) iron and steel (the value of the last four items ranging between 24 and 30 million francs). These facts are sufficient to explain why in 1933, for example, the value of Indian goods imported into France was about six times greater than the value of French goods exported to India, or again why in 1937-38, which was a year of heavy French exports to India, French exports to this country were only 12·2 per cent of Indian exports to France.

SWITZERLAND

Switzerland seems to be the only country in Continental Europe which succeeded during the inter-war period in not only reducing her adverse balance of trade with India, but also

converting the adverse balance into an active balance in 1937. The adverse balance was progressively reduced from 9,271,489 francs in 1930 to 3,196,214 francs in 1931, 4,531·3 francs in 1932, 1·7 million francs in 1934 and ·5 million francs in 1935. In 1937 there was an active balance of trade with India to the extent of 1·2 million francs. During this period Switzerland entered into compensation agreements with a number of countries. In 1935 no less than 32·6 per cent of the total value of Swiss imports came from countries which had concluded clearing agreements with Switzerland, and these countries absorbed 25·8 per cent of the total Swiss exports. Switzerland's principal imports from India were (1) food-stuffs (rice, coffee, tea, sago and tapioca, edible oils) and (2) raw materials for industry (skins, raw hides, oilseeds, cotton, hemp and flax, jute, coir, rubber, gum, and shellac). Swiss exports to India were principally steam engines, turbines and watches.

CZECHOSLOVAKIA

The trend of Indian trade with Czechoslovakia during the inter-war period is illustrated by the following statistics :—

VALUE OF IMPORTS AND EXPORTS AND BALANCE OF TRADE

(in million Kc)

	Imports from India	*Exports to India*	*Balance + or −*
1930	332	169	−163
1931	207	134	− 73
1932	110	100	− 10
1935	290	86	−204
1936	302	78	−224

The reduction in Czechoslovakia's adverse balance of trade with India during the period 1930-32 may be quite in keeping with the prevailing tendency which we have observed

in the case of other countries of Europe . But the considerable increase in the value of Indian imports into Czechoslovakia in 1935 and 1936 in the face of a continuous fall in her exports to India was a remarkable phenomenon, the explanation of which is to be found in the tariff policy of Czechoslovakia. This country protected her agriculture by means of tariff and, to a considerable extent, replaced the imports of foodstuffs by the imports of industrial raw materials required by her growing industries. But she kept herself free from the entanglements of bilateral trade and compensation and clearing agreements which dominated continental trade. Thus she pursued a deliberate policy of restricting her trade with countries which would trade only on the basis of clearing agreements and of increasing her trade with countries who were prepared to pay free exchange for her purchases. In consequence of this policy Czechoslovakia's trade with India expanded. Her imports from India had increased considerably after 1932, although her exports had declined, so that the adverse balance of her trade with India had mounted heavily. In 1937, however, while her imports from India increased by 60 per cent (as compared to 1936), her exports to India increased by 107 per cent. But we must remember that Czechoslovakia's policy of liberalizing trade by discriminating against countries which practised trade restrictions, however sound in principle, had serious limitations for a small, isolated and economically weak country when few of the stronger countries of the world shared her faith in a liberal tariff policy.

THE UNITED STATES OF AMERICA

During the inter-war period India's trade, in common with the trade of other tropical agricultural countries, with the United States maintained its largely one-sided character and resulted in a net export to the United States. In 1938 Tropical Asia accounted for 18 per cent of the United States' imports but for only 5 per cent of the United States' exports. In 1936 the ratio of exports to imports in the United States' trade with India was 38 per cent which was approximately the same as in 1929. On the other hand, the trade of the

United States with Europe, the United Kingdom and the Regions of Recent Settlement in the Temperate Belt had always resulted in a substantial active balance. We can realize the full significance of these trends of trade when we consider the type of American export products and the nature of the goods which the U.S.A. was prepared to import. As a country with a highly diversified economy the United States exported agricultural products as well as manufactured goods. After the last war she began to receive a net import of raw materials, and during the 'thirties the previous export surplus of foodstuffs was converted into a growing import surplus. These were merely symptoms of a more intensive industrial development and of a shift from agriculture to industry. The staple exports of the United States have consisted of 'high-income', consumers' goods, particularly durable consumers' goods, as well as capital goods, into the production of which a good deal of capital enters, and which are likely to be absorbed by countries with progressive economies in which economic development stimulates the demand for capital goods as well as 'high-income' consumers' goods. The principal commodities exported by the United States to India during the inter-war period were rubber and manufactures, leaf tobacco, raw cotton, cotton cloth, petroleum and products, iron and steel-mill products, advanced manufactures of iron and steel, electrical machinery and apparatus, industrial machinery, type-writers, automobiles, parts and accessories; and medicinal and pharmaceutical goods. In 1932-33 the share of the United States in total imports (under each of these heads) was comparatively high in the case of motor vehicles (36·5 per cent), instruments and appliances (13·9 per cent), machinery (7·7 per cent), liquors (6·9 per cent), chemicals (5·4 per cent), hardware (5·6 per cent). The imports of a country like the United States ought to consist of goods into the production of which a good deal of labour has entered. Thus she has naturally become the best market for the products of the tropical agricultural countries. But the United States Tariff has excluded the manufactured products available from Europe and Japan into the production of which also a good deal of labour has entered, apart from discouraging imports

from countries which have developed a high degree of industrial efficiency with methods of large-scale production. These facts explain why the trade of the United States should have been characterized by an active balance with Europe, the United Kingdom and the British Dominions and by a large passive balance with South-East Asia.

But an important factor which profoundly influenced world economy in the inter-war period was the tendency for the United States' active balance of trade with one group of countries to far exceed her passive balance of trade with the other. As a new creditor nation after the last war she secured equilibrium in her balance of payments by foreign lending and, when the flow of foreign loans ceased, by imports of gold. But the cumulative effects of this policy were disastrous and intensified the economic depression. Her active balance of trade with Europe, the United Kingdom and Countries of Recent Settlement contracted considerably between 1928 and 1938. At the same time her passive balance of trade with Japan and the rest of the world, excluding Tropical Asia, was converted into an active balance. But South-East Asia was the only group which continued to have an active balance of trade with the United States, although the size of this balance decreased during this period.

India's active balance of trade with the United States, which had been Rs. 17 crores in 1913-14, was Rs. 5 crores in 1934-35, Rs. 7 crores in 1935-36, Rs. 12 crores in 1936-37 and Rs. 6 crores in 1937-38. During the early phase of the depression the trade of the United States with India contracted as a result of the relative appreciation of the dollar in terms of rupees, and American imports into India declined from Rs. 15 crores in 1930-31 to Rs. 7 crores in 1933-34. Subsequently the fall in the value of the dollar to the old par rate in May, June and July 1933 and the subsequent further decline to $5·46 to the pound in November 1933 gave a stimulus to American exports to India. American imports from India increased by 26 per cent in 1934, and although a considerable part of the increase was due to the higher level of import prices, yet American purchases of a number of commodities were larger in 1934 than in 1933. The same tendencies continued in later years before the outbreak of

the present war. But, as already pointed out, even in 1936 the ratio of American exports (to India) to imports (from India) in the trade with India was approximately the same as in 1929.

JAPAN

Before the last war Japan was an important exporter of raw materials and semi-manufactures (like raw silk, silk tissues and cotton yarn) to Europe and the United States which absorbed such exports in exchange for manufactured goods. During the last war Japan succeeded in capturing the Asiatic market for cotton textiles and tried to make herself independent of the supply of manufactured products from Europe. The expansion of the market for raw silk in the United States after the war further strengthened Japan's position as an exporting country. During the depression the collapse of the prices of raw silk caused a drastic fall in Japanese exports to the United States, but her imports from the U.S.A. of essential industrial raw materials (such as cotton, iron scrap, copper and mineral oil) went on increasing in consequence of industrial development in Japan. Hence Japan's active balance of trade with the United States was eventually transformed into a passive balance. Naturally Japan was interested in bringing about a compensatory change in her balance of trade with Asiatic countries like India. Thus the passive balance of trade with these countries was gradually reduced and was eventually converted into an active balance mainly by initiating a planned drive for the export of 'low-income' goods adapted to the requirements of Asiatic countries. The following table indicates this trend which was reflected in India's balance of trade with Japan.

INDIA'S BALANCE OF TRADE WITH JAPAN
(Crores of Rupees)

1913-14	.. +18
1934-35	.. + 3
1936-37	.. + 9
1937-38	.. − 3

During the inter-war period the percentage share of India in Japanese imports of agricultural products declined appreciably as the following comparative figures show.

PRINCIPAL IMPORTS OF JAPAN FROM INDIA
(Percentage Share)

	1925	1935
Rice and paddy	.. 40·4	6·0
Raw cotton	.. 51·5	36·3
Crude rubber	.. 17·6	·4
Phosphorite	.. 6·0	..
Vegetable fibre	.. 20·2	16·7
Ores	.. ..	8·2
Pig iron	.. 50·9	30·9
Lead ingots and slabs	.. 25·3	22·8

In the decade 1921-32 India supplied 50 per cent, and the U.S.A. 40 per cent, of Japanese requirements of raw cotton. During 1931-35 the position was exactly reversed. In 1925 India supplied 17·6 per cent of rubber. By 1933 while India supplied 1·2 per cent, the Netherlands Indies increased her share to 24·5 per cent. In pig iron, lead and zinc India's position was comparatively strong. India held the third place in the order of importance as an exporter of lead to Japan. India and Australia supplied 65 per cent of Japan's requirements of zinc in 1935.

When we observe the variations in Japan's principal exports to India the trend is strikingly different. In 1932-33 three-quarters of the Japanese exports to India fell within the textile group and were subject to protective and other discriminatory restrictions. With effect from 23 December 1933 by virtue of the Indian Tariff (Amendment) Act minimum specific duties were imposed on a number of articles of non-British origin which included miscellaneous goods such as boots and shoes, certain chemicals, hosiery,

woollen fabrics, paints, soap, certain items of glassware, cast-iron pipes, umbrellas, etc. These duties were pitched at rates which were intended to restore Japanese prices to the level existing before the depreciation of yen. But the adaptability of Japanese trade and industry was such that although there was a set-back in certain lines due to tariff barriers, yet increasing competition appeared in a widening variety of goods. Hence Japan's share in imports into India actually increased from 7·5 per cent in 1925 to 9·2 per cent in 1929, 11 per cent in 1933, 15 per cent in 1935 and 16·2 per cent in 1936. India ranked second to the U.S.A. as a market for Japanese camphor. She used to absorb 25 per cent of Japanese silk. She consumed 60 per cent of woollen piece-goods in 1925 and 13 per cent in 1933. India along with Manchuria was the chief market for Japanese iron manufactures and consumed 14 to 19 per cent of her output. India was the second principal market for Japanese pottery, her share each year ranging between 8 and 10 per cent. As regards glass and glass manufactures India topped the list, and her purchases increased from 19 per cent in 1925 to 31 per cent in 1929 and 27 per cent in 1935. Next to the U.S.A. and the United Kingdom India was the third principal market for Japanese toys and took 8 to 10 per cent of the entire output. India was the second most important market (next to U.K.) for buttons and absorbed 8 to 13 per cent. As regards jewellery India's share was 30 per cent. She also absorbed 9 per cent of the exports of boots and shoes in 1929, 13 per cent in 1934 and 9·1 per cent in 1935.

BRITISH EMPIRE EXCLUDING THE UNITED KINGDOM

Amongst the countries included in this broad group we must observe a distinction between Advanced Primary countries represented by the British Dominions and the British Colonial Empire, for India's trade relations with these two groups show distinct peculiarities.

Trade statistics embodied in the following comparative tables clearly show that the extent of intra-empire trade, if the United Kingdom is excluded, is of a rather limited character.

PERCENTAGE OF TOTAL IMPORTS RECEIVED

Country	*Imports received from Empire countries*	*Imports received from non-empire countries*	*Imports received from U.K.*
New Zealand (1935) ..	73·3	26·7	50·4
Australia (1934-35) ..	60·3	39·7	43·1
South Africa (1935) ..	57·6	42·4	48·0
Canada (1934-35) ..	29·9	70·1	21·4
India (1934-35) ..	49·4	50·6	40·6
United Kingdom (1935) ..	37·6	62·4	..

	Percentage to total imports of imports coming from the British Empire excluding the United Kingdom.[4]
New Zealand (1935) ..	22·9
Australia (1934-35) ..	17·2
South Africa (1935) ..	9·6
Canada (1934-35) ..	8·5
India (1934-35) ..	8·8

The British Empire, excluding the United Kingdom and her colonial empire, consists of countries producing primary goods which are in different stages of economic development but maintain their essential character as agricultural or mining countries. Their trade with one another is naturally confined to products of agriculture or mining which are non-competitive and supply one another's deficiencies. The range of this trade has been rather limited. New Zealand and Australia seem to derive 22·9 and 17·2 per cent respectively of their total imports from within the empire group. South Africa, Canada and India are far less dependent for their imports upon this group and derive less than 10 per cent of their

4. The figures are derived by subtracting the figures in the fourth column of the previous table from the corresponding figures in the second column.

imports from within this group. The staple primary products of these countries have their principal markets in countries with highly developed manufacturing industry which export to them manufactured goods and capital goods needed for public utilities (such as irrigation, hydro-electric works and transportation). Their political and financial ties with the United Kingdom, strengthened by the system of empire preferences, have directed their trade largely towards the United Kingdom. Since the pace of their economic development has been set by a large amount of foreign capital borrowed mainly from the mother country, they have developed an export surplus which has enabled them to pay the amount by which interest, dividends and payments on account of services have exceeded the current import of new capital. Their trade with highly industrialized countries was more widespread and hence more expansive, and secured better and more stable prices for their primary products so long as the multilateral trading system had been working. But during the inter-war period with the blocking of the indirect transfer routes the so-called 'empire free trade', based on tariff discrimination against non-empire countries, necessitated a bilateral balancing of accounts between the mother country and each of the countries that we have been considering. Thus where debtor countries had active balances of trade with the United Kingdom before the economic depression, these active balances had to increase substantially to meet the debt services and the payment for shipping and other services. For example, in the case of British Dominions the total active balance increased from $41,000,000 in 1928 to $367,000,000 in 1938. Where the debtor countries had previously passive balances of trade with the United Kingdom, the passive balance had to be drastically reduced and even converted into an active balance before a bilateral balancing of accounts was at all possible. For example, the passive balance of trade of India, Burma and Ceylon with the United Kingdom which had been $139,000,000 in 1928 was converted into an active balance of $96,000,000 in 1938. But it should be noticed that although the pressure in the direction of bilateral balancing of accounts between the mother country and each one of the debtor countries was calculated to divert their

trade to the United Kingdom, yet, as the figures given above show, their imports from non-empire countries were still considerable. This was specially true of India and Canada.[5] Another consequence of the re-orientation of the trade balances of these countries during the inter-war period was that in view of the extreme pressure upon their balances of payments which these countries experienced they tried to avoid a passive balance in their trade with one another and to develop and expand mutually advantageous trade by means of reciprocal tariff preference.

India derived only 8·8 per cent of her imports from the Dominions, British colonies, Protectorates, etc., in 1934-35. Her imports from the Dominions have been confined to a narrow and rather inelastic range. Before the present war there was a limited market in India for wool, cereals, meat, butter, canned fruits, and processed and manufactured foods which are either 'high-income' goods, or are not adapted to the requirements of a tropical country. There was a limited market too for products of forestry, agriculture and mining which met a specialized demand in certain industries. We also notice an intermittently heavy demand for gold and silver and for wheat in abnormal years. On the other hand, India exported to these countries tropical specialities like jute, oil-seeds, hides and skins, tea, coffee, etc. India did not enter into agreements with the Dominions for the promotion of trade on the basis of reciprocal tariff preference.

Australia:—In 1921-22 the principal Indian exports to Australia were rice, tea, linseed, coffee, mats and matting coir, hessian, bags and sacks and precious stones. India imported from Australia wheat, horses, wool, tallow, coal and gold. Wheat and gold amounted in value to £4,181,621 and £1,294,150 respectively. It was generally felt that there was little scope for the expansion of Indian trade with Australia. During the depression Indian exports to Australia were largely confined to indispensable items, such as

5. Canada's commercial contact with the United States, her next-door neighbour, is naturally much more intimate and transcends imperial considerations.

hessian, cornsacks and woolpacks, linseed, tea and hides and skins. The Australian trade delegation which visited India, Burma and Ceylon in 1935 found that the market for Australian goods of the type of tinned and bottled fruits, jams, better classes of biscuits, confectionery, wines, etc., (which Australia was interested in supplying) was confined to less than 1 million of Indian population. In respect of many of these items Australia was placed on the same footing as foreign countries, and in the absence of a reciprocal preferential agreement between India and Australia, the United Kingdom enjoyed a tariff advantage of 10 per cent *ad valorem*.

Canada :—India's trade with Canada was more diversified and had a broader basis than her trade with Australia. Curiously enough each of them exported to, and imported from, the other goods under every category.

	Imports into Canada from India	*Exports to India from Canada*
	(9 months ending December 1929) (in thousands of dollars)	
Agricultural and vegetable products ..	2,594	1,337
Animals and animal products ..	31	33
Fabrics, textiles and products ..	4,060	108
Wood and paper ..	4	22
Iron and its products ..	5	2,535
Non-ferrous metal products ..	64	2,594
Non-metallic mineral products ..	42	23
Chemicals and allied ..	4	109
Miscellaneous ..	149	29

It is clear that in respect of agricultural and vegetable products, fibres (textile and products), non-metallic mineral products (i.e., mainly raw materials of industry), India had an excess of exports over imports in relation to Canada in 1929. In respect of wood and paper and particularly iron and its products and non-ferrous metal products, Canada had an

excess of exports over imports in relation to India. Canada's principal exports to India, being manufactured goods, are competitive with similar goods imported into India from industrial countries. But Indian exports to Canada consist largely of special products of tropical countries (specially jute and tea). After 1930 Canada entered into tariff treaties with Australia, New Zealand and South Africa by which they agreed to concede to each other special rates of duties lower than the intermediate and general tariff rates in the case of certain classes of goods. But although India had no tariff reciprocity with Canada yet India's share in Canadian imports increased from 1 per cent in 1932 to 1·3 per cent in 1935, and imports from India into Canada actually increased by 46·5 per cent in 1935 as compared with 1932, while imports from Australia and Africa increased by 26·5 per cent and 16 per cent respectively. India's active balance of trade with Canada increased from 163,000 dollars in 1929 to 1½ million dollars in 1931, 2¼ million dollars in 1933 and 2½ million dollars in 1934.

South Africa:—The trend of India's trade with South Africa is indicated below.

	Average 1910-14	*Average* 1925-29	*Average* 1930-34
	(Total values in thousand £)		
Exports from India ..	1007	2636	1490
Imports into India ..	58	9492	1232
Balance of trade ..	+949	—6856	+258

In 1925 India was the principal country of origin as regards imports of foodstuffs (like ghee, rice, oils, spices and tea); textiles, apparel, yarns and fibres; oils, waxes, resins, paints and varnish; and wood, cane, wicker and manufactures. During the period of depression imports from India formed a steady proportion. Jute goods formed 60 per cent of imports in 1932, and a large part of the remainder consisted of non-competitive lines, such as rice, paraffin wax, teak and tea,

typical tropical products. South Africa's exports to India were mainly coal and stores supplied to shipping, specie and bar gold and rough diamonds. India's large passive balance of trade with South Africa in 1925-29 was due to considerable imports of gold coin and raw gold. In 1933 India occupied the fifth place among countries from which South African imports were derived.

New Zealand:—India's trade with New Zealand always had a narrow basis and a one-sided character. Pastoral products (meat, wool and dairy products) formed as much as 92·4 per cent of New Zealand's exports in 1935, and the United Kingdom absorbed as much as 76 per cent of these exports in 1938. Pastoral products of the type produced by New Zealand have a very restricted market in India. In 1935 the principal products imported into India from New Zealand were butter (£11,664), dried milk (£10,099) and tallow (£42,223). On the other hand, New Zealand imported from India mainly jute, hessian hemp, corn bags and sacks, wool packs, and tea. The largely one-sided character of trade created in the past a substantial active balance of India's trade with New Zealand. For example, in 1935 imports from New Zealand into India were valued at £60,956, while Indian exports to New Zealand were valued at £532,786, so that India's active balance of trade with New Zealand in that year was as much as £470,830.

BRITISH COLONIAL EMPIRE

India's trade with the British colonial empire has been very largely confined to British colonies bordering on the Indian Ocean and in South-East Asia. Her trade with this group of countries specializing in primary production has exhibited striking peculiarities. These tropical countries are not whitemen's settlements like the British Dominions, but are inhabited by Asiatic people whose consumption approximates to the lowest of Asiatic standards. These colonies constitute, therefore, what may be called 'price markets' in which cheap (though shoddy) goods adapted to the habits and requirements of Asiatics can command a ready sale. This advantage combined with the geographical advantage of

proximity, which India possesses, have been responsible for a fairly large export trade in manufactured goods which she has been able to build up in the past. To illustrate this interesting aspect of India's trade which has a great significance for the future we shall discuss briefly the trend of India's trade with British East Africa, Ceylon and British Malaya during the inter-war period.

British East Africa:—Before the depression India accounted for 10 per cent of imports of Kenya and Uganda, 13 per cent of imports of Tanganyika, 34 per cent of imports of Zanzibar, 13 per cent of imports of Nyasaland and 2 per cent of imports of Northern Rhodesia. India's principal exports were non-ferrous metals and manufactures; woollen and worsted yarns; haberdashery and apparel; leather and manufactures; bleached, unbleached, printed, dyed and coloured piece-goods; blankets. The trade in cotton textiles deserves special mention. Indian cotton textiles which represented special categories of goods accounted for 15 per cent of the imports of cotton textiles into East Africa, as against 25 per cent imported from the U.S.A. and 60 per cent imported from Japan. In printed goods the strength of Indian as well as Japanese competition affected both British and Dutch trade. In dyed goods India and Holland were powerful competitors of the United Kingdom. In regard to cotton blankets India required a specialized attack on the market to regain the trade that had been lost some years previously to Holland. India was competing fairly strongly with Great Britain in the supply of tent canvas, green jute and white cotton canvas, tarpaulins and waxed cotton tissues. Indian undressed leather had a big market in East Africa. In boots and shoes Great Britain and India supplied the major part of the market. Before the depression Dutch and Japanese selling cartels were found to be using their power of controlling credit in extending sales. On the other hand, Indian trade in textiles was governed by D.P. terms between Bombay and East Africa. During the depression India's exports to East Africa registered a heavy decline. Her share in the imports of Kenya and Uganda decreased from 10 per cent in 1927 to 7·6 per cent in 1933; her share in the imports of Tanganyika decreased too from 13 per cent in 1927 to 7·1

per cent in 1933; and her share in the imports of Zanzibar also decreased from 34 per cent in 1927 to 28·7 per cent in 1933. Japan's increasing penetration into the East African market undermined the position of the Indian export trade, particularly in textiles. Indian exporters were powerless against the Japanese methods of trade expansion, such as 90-120 D.A. terms freely given to importers of standing, ex-ship selling of goods consigned upon optional bill of lading and price-cutting with the object of ousting rival competitors. India's principal imports from East Africa have been cotton (of which she consumed increasing quantities between 1925 and 1929), carbonate of soda, cloves, ivory, skins of sheep and goats, and asbestos (imported since 1934 from Southern Rhodesia).

Ceylon:—Ceylon's economic products, with the exception of tea, are raw materials which are exchanged in the world's markets for manufactured goods and foodstuffs. By reason of geographical advantage and also because India can supply Ceylon with the type of foodstuffs and manufactured goods which she needs, the trade relations between the two countries are naturally very close. The general nature of trade between them is indicated by the following table.

	Value of exports to Ceylon		*Value of imports into India*
	Rs.	1935	Rs.
Food, drink and Tobacco ..	28,306,234		2,134,769
Raw materials and articles mainly unmanufactured ..	6,934,060		9,645,169
Articles wholly or mainly manufactured ..	9,015,283		234,371
Animals not for food ..	71,592		1,061
Total ..	44,327,119		12,015,370
India's balance of trade	+32,311,749		

It is quite evident that in 1935 India had a large net export to Ceylon in respect of foodstuffs and manufactured goods, the type of goods which Ceylon requires to obtain by trade. Goods imported from India into Ceylon which represented more than 50 per cent of the total value of imports in each case in 1935 were (1) foodgrains other than rice, (2) bran and pollard, (3) gingelly, (4) goats and sheep, (5) chillies, (6) eggs, (7) cured fish, (8) onions, (9) raw cotton, (10) unrefined sugar, (11) vegetable oils, (12) rubber, (13) tiles, (14) textile manufactures of mixed materials, (15) artificial silk, (16) jute hessian, (17) gunny bags, (18) printed books. India seemed to have an established market in Ceylon for piece-goods. The quantity of Indian piece-goods imported into Ceylon increased from 16 per cent of the total quantity of such goods imported from all sources in 1934 to 35 per cent in 1935. On the other hand, Ceylon had a net export to India in respect of raw materials which India requires. Ceylon's economic prosperity depends on income derived from the export of tea, rubber and products of the coconut palm. But India's principal imports from Ceylon in 1935 were (1) copra (India consuming 75 per cent of total exports); (2) coconut oil (India consuming 23 per cent of Ceylon's exports); (3) fresh coconut (India consuming 37 per cent of Ceylon's exports); (4) arecanuts (India consuming 85 per cent of Ceylon's exports); (5) unmanufactured tobacco (India consuming 100 per cent of Ceylon's exports); (6) skins, dressed and undressed (India consuming 72 per cent of Ceylon's exports). As the table given above shows, Ceylon had a large passive balance of trade with India in 1935 to the extent of more that Rs. 300 lakhs which had to be offset against Ceylon's active balance of trade with countries like the United Kingdom which purchased the bulk of Ceylon's staple agricultural products like tea and rubber.

British Malay:—The general trend of India's trade with British Malay is indicated by the following statistics:—

	Percentage of exports from India to total imports into British Malay
1926	.. 8·8
1927	8·2
1928	.. 8·2
1929	.. 8·4
1930	.. 9·0
1931	.. 9·2
1932	.. 8·9
1933	.. 8·8

Although the absolute value of India's exports to British Malay decreased during the depression, yet, as the figures show, on the whole the relative share of India in British Malay's imports increased during this period. In 1933 the total value of Indian exports to British Malay was 13·7 million dollars, and the total value of imports from British Malay into India was 11 million dollars, so that there was a fairly large balance in favour of India to the extent of 2·7 million dollars.

Indian exports to British Malay were largely manufactured goods of the following categories :—

(1) non-ferrous metals and manufactures (30 out of 400 tons imported from India); (2) cotton yarns, grey and unbleached (1,201,648 lbs. in 1929); (3) plain piece-goods; (4) piece-goods dyed in the piece (3·7 million yards in 1930); (5) cotton *sarongs, slendangs* and *kains* (2·3 million yards in 1930); (6) jute, twine or yarn (supplied mostly by India); (7) hats, caps and other headgear ($106,811 in 1930); and (8) skins, tanned and undressed ($312,334 in 1930). In British Malay, as in other parts of the British colonial empire during the 'thirties, the Indian export trade in textiles was adversely affected by intense Japanese competition. Consequently the percentage of woven coloured cotton goods imported from India to total imports of such goods declined from 73·4 per cent in 1931 to 5·8 per cent in 1934. Similarly the percentage share declined from 35·1 per cent to 14·3 per cent in the case of cotton, *sarongs, slendangs* and *kains*. The bulk of Indian imports from British Malay consisted of typical products of South-East Asia like tin, sago, liquid fuel, coconut oil, arecanuts, copra, rattans, black pepper, etc.

THE UNITED KINGDOM

We have already noted the remarkable changes in India's balance of trade with the United Kingdom during the inter-war period. The large passive balance of trade which India used to have in relation to the U.K. before the last war was progressively reduced during the inter-war period till in 1936-37 it was finally converted into an active balance. The increasing penetration of other industrial countries into the Indian market after the last war was responsible for a gradual decrease in India's passive balance of trade with the U.K. But during the period of depression the change in the United Kingdom's balance of trade with India in the direction of passivity was accelerated owing to causes which were more fundamental than were imagined at that time. India's passive balance of trade with the U.K. could be sustained so long as India's active balance of trade with other countries was large enough to offset this passive balance through the system of multilateral clearing and yet leave a sufficient margin which enabled India to meet the amount by which the payment of interest, dividends and remuneration for 'services' exceeded the new capital imports. But during the period of depression the collapse of demand for primary products as much as the difficulties of multilateral clearing made it impossible for India to maintain the previously large net export to countries other than the United Kingdom. Hence India's balance of payments position required a bilateral settlement of payments with the United Kingdom *as far as possible*. There was no other alternative means of maintaining equilibrium in the balance of payments between a creditor and a debtor country. But bilateral settlement of payments in this case meant a considerable shift in the United Kingdom's balance of trade with India in the direction of 'passivity'. Secondly, it implied the diversion of Indian trade into bilateral channels as far as possible, and the system of reciprocal tariff preference evolved at Ottawa was a means to that end. But the situation was fundamentally too difficult to yield to mere tariff manipulation. We propose to review India's trade with the United Kingdom during the inter-war period from this point of view. For

convenience of analysis the trends of India's export trade and import trade will be discussed separately.

A concrete picture of the trend of India's export trade during the inter-war period can be obtained from the following statistical tables:—

TOTAL VALUE OF EXPORTS
(in Lakhs of Rupees)

	1931-32	1932-33	1933-34	1934-35	1935-36
To the United Kingdom ..	42,88	36,82	47,21	48,07	49,80
Index number ..	100	85·9	110·1	112·1	116
To other countries ..	114,68	96,45	100,31	104,32	110,68
Index number ..	100	84·1	87·5	90·9	96·5

INDIAN EXPORTS TO THE UNITED KINDOM
(Percentage to total exports)

1932-33 ..	28	1934-35	31·6	1936-37	32·1
1933-34 ..	32·2	1935-36	31	1937-38	34·9

RATE OF INCREASE OF EXPORTS TO U.K. AND OTHER COUNTRIES

	Percentage increase in 1933-34 *compared to* 1932-33	*Percentage increase in* 1934-35 *compared to* 1933-34	*Percentage increase in* 1935-36 *compared to* 1934-35	*Percentage increase in* 1935-36 *compared to* 1932-33
U.K. ..	28·2	1·8	3·6	35·2
Other Countries ..	4	3·9	6	14·75

The total value of exports to the United Kingdom increased from Rs. 42,88 lakhs in 1931-32 to Rs. 48,80 lakhs in 1935-36, whereas the total value of exports to other countries decreased from Rs. 114,68 lakhs to Rs. 110,68 lakhs during

the same period. But even a cursory inspection of the first table reveals two outstanding facts. First, after a considerable shrinkage in exports in 1932-33 as compared to 1931-32, the shrinkage in exports to other countries being very much greater than the shrinkage in exports to the United Kingdom, the index numbers of total values of exports in the two cases moved near, but thereafter there was a *continuous upward trend in exports to both the United Kingdom and other countries,* although the index numbers of total export values diverged. Secondly, it is quite obvious that although India's export trade was increasingly diverted to the United Kingdom after 1932-33 in consequence of the Ottawa preferences, yet India received a little less than 70 per cent of the total value of exports from countries *other* than the United Kingdom. The figures shown in the second table are revealing in this connexion. It will be noticed that the percentage share of the United Kingdom in India's export trade which had fallen to the low figure of 28 per cent in 1932-33, shot up to 32·2 per cent in 1933-34, the first year of the working of the Ottawa Agreement. There was a decline in this percentage during the next two years, followed by a gradual increase till in 1937-38 it rose to 34·9 per cent which was 'a record figure in the history of the trade relations of the two countries during the present century'. For a proper assessment of the effects of the Ottawa preferences upon these trends of trade the statistics shown in the third table have an important significance. During the three years of the life of the Ottawa Agreement, 1932-33 to 1935-36, India's export trade with the United Kingdom increased by 35·2 per cent, while her trade with other countries expanded by 14·75 per cent. But we should notice that the rate of increase of Indian exports to the U.K. slowed down from 28·2 per cent in the first year to 1·8 per cent in the second year, but doubled itself from 1·8 per cent to 3·6 per cent in the third year. On the other hand, the rate of expansion of Indian exports to other countries (in spite of trade restrictions and transfer difficulties which were the cause as well as the effect of the system of empire preferences) was 4 per cent in the first year of the Agreement, 3·9 per cent in the second year and as much as 6 per cent in the third year.

The slowing down of the rate of increase of Indian exports to the United Kingdom after the first year of the Agreement has a very obvious explanation. The demand for Indian tea showed inelasticity, and, moreover, such expansion of demand for Indian products as had occurred was confined to raw-materials of the engineering and building industries rather than to agricultural raw materials for which the demand showed little variation. The reason why the demand for the latter category of raw materials remained inelastic was that the British industries consuming them were still paralysed by the economic depression, while many countries were expanding their industry and trade by various unorthodox methods. Japan and Germany made a bid for the capture of the Indian market against which tariff preference in the case of British goods was unavailing.

Another significant fact which should be taken into account is that the expansion of Indian exports to the United Kingdom was not solely due to the effects of the Ottawa Agreement. During the first two years of the life of the Agreement exports to the United Kingdom of commodities subject to preferential treatment rose from Rs. 29·7 crores in 1932-33 to Rs. 36·7 crores in 1934-35, showing *an increase of 23·4 per cent.* But exports to the United Kingdom of commodities not subject to preferential treatment increased from Rs. 7·09 crores in 1932-33 to Rs. 11·36 crores, showing *an increase of 60·3 per cent.*

The expansion of India's exports to the United Kingdom in 1936, 1937 and 1938 has been attributed by some to the Ottawa Agreement. But apart from what has already been said, during these years the effects of preference were obscured by the expansionary effects of the upswing of the trade cycle which coincided with, if it was not caused by, stockpiling and the rearmament boom in anticipation of the war. As we have already seen, the demand for industrial raw materials which India exports showed a tendency to expand in the countries of continental Europe. Indian exports to the United Kingdom also increased during this period for similar reasons. Exports of Indian wheat to the United Kingdom increased from £782,244 in 1935, to £2,077,869 in 1936 and to £4,308,030 in 1937. It is on record that in 1938

Government purchases of wheat were responsible for the slight improvement in the price of wheat in the United Kingdom. Tobacco exported from India to the United Kingdom in 1937 was the maximum so far recorded. Imports of Indian pig iron into the United Kingdom showed a remarkable increase in 1935, 1937 and 1938. The value of exports of Indian manganese to the United Kingdom in 1937 was the highest for a number of years. During 1937 India exported 9,970 tons of crude rubber against a permissible quota of 10,469 tons. Exports of Indian coffee to the United Kingdom in 1937 were fairly high, and in 1938 the proportion of sales of Indian coffee to total sales in London was higher than in previous years. The trend of Indian exports of some of the other important industrial raw materials is indicated by the following table :—

	1935	1936	1937
Linseed (thousand tons) ..	58·4	221·5	192·5
Groundnuts (thousand tons) ..	89·8	109·8	138·0
Jute sacks and bags (thousand cwt.) ..	714·5	999·3	1017·1
Teak wood (thousand cubic ft.) ..	1788	2273	2322
Shellac (thousand cwt.) ..	86·7	128·8	173·0
Hides, leather undressed (thousand cwt.) ..	259·3	327·8	373·0
Short staple cotton (bales of 100 lbs) ..	825·4	1230·1	1376·5
Pig steel (thousand cwt.) ..	42·3	50·5	49·7

A study of the trend of British imports into India after the onset of the depression shows that the Ottawa preferences and the already existing differential duties in the case of cotton, artificial silk textiles and iron and steel, did not give as much impetus to the British import trade as was intended or expected. Before we seek an explanation of this pheno-

menon it is necessary to review the statistical position which is indicated below:

PERCENTAGE OF BRITISH IMPORTS TO TOTAL IMPORTS INTO INDIA

1931-32	.. 36	1933-34	.. 41	1936-37	.. 38
1932-33	.. 37	1934-45	.. 41	1937-38	.. 30
		1935-36	.. 39		

INCREASE IN THE VALUE OF BRITISH IMPORTS (in lakhs)

1933-34 compared to 1932-33	.. +164
1934-35 compared to 1933-34	.. +199
1935-36 compared to 1934-35	.. + 8

IMPORTS OF PREFERENTIAL AND NON-PREFERENTIAL ITEMS

(Percentage share)

Preferential items	1931-32	1932-33	1933-34	1934-35	1934-35 *7 months*	1935-36 *7 months*
United Kingdom ..	41	40	46	44	43·1	43·6
Others ..	59	60	54	56	56·9	56·4
Non-preferential items						
U.K. ..	33·7	35·8	39·4	39·3	38·8	36·5
Others ..	66·3	64·2	60·6	60·7	61·2	63·5

The United Kingdom's share in total imports into India had reached 36% in 1931-32 after a steady decline for 15 years from the post-war peak of 61 per cent in 1920-21. After coming into force of the Ottawa preferences on 1 January 1933 the percentage share for the year 1932-33 rose to 37. During the first two years of the life of the Ottawa Agreement the percentage share rose to 41 and remained steady at that figure. But the improvement was arrested, and once more

a decline set in. The fall in the percentage from 38 in 1936-37 to 30 in 1937-38 was mainly due to the change in the presentation of statistics incidental to the separation of Burma. After making the necessary adjustment the comparable figure would be 35·4 per cent which was almost as low as the figure for 1931-32. It would appear from the statistics given in the second table that there was a considerable increase of British imports in the first two years of the life of the Ottawa Agreement after which there was a sudden drop. The figures in the third table reveal that the United Kingdom improved her share of the trade equally in preferential and non-preferential items in the first two years of the life of the Ottawa Agreement.

The factors which seem to have more than neutralized the effects of the preferential tariff are not far to seek. The principal competitors of the United Kingdom in the Indian market were Japan, the U.S.A. and Germany. In cotton manufactures the main competitor was Japan. The main competitors in other staple lines were Belgium in iron and steel; the U.S.A. and Germany in machinery; the U.S.A., Germany and Japan in hardware; the U.S.A. in motor vehicles; Japan, Germany and the U.S.A. in instruments and appliances; the U.S.A., Germany and Japan in chemicals; the U.S.A. and Germany in liquors and paper. During the depression there was a heavy decrease in the domestic consumption of luxuries and semi-luxuries, motor cars, tobacco and liquors thus showing a level of consumption in 1932 which was 58 per cent of the average for 10 years ending 1930. The consumption of the necessaries for the masses (cotton piece-goods, kerosene oil, salt) was 78 per cent, while the consumption of requirements of industry (machinery and millwork, lubricating oil, chemicals, etc.) was as high as 70 per cent. In 1933-34 the two main items of British exports to India were cotton textiles and machinery which accounted for 36% of the U.K.'s total exports to India. There was a heavy decline in British exports to India under both these categories. But the United Kingdom's share in total imports rose from 37 per cent to 41 per cent because of the increase in the imports from the United Kingdom of a wide variety of miscellaneous goods. Japanese competition in this class of

goods had been counteracted, at least in certain lines, by specific import duties. The abandonment of the gold standard in 1931 had also given the U.K. an advantage against the U.S.A. But the devaluation of the dollar in 1934 neutralized this advantage. Moreover, unorthodox methods of expansion of trade, such as subsidies, barter agreements, currency depreciation and multiple currency practices, making good the loss sustained on the sale of preferential items by profits on the sale of goods in which competition was weak, dumping from behind the tariff wall, etc., enabled both Japan and Germany to undersell British manufactures in spite of the preferential tariff. The United Kingdom was exposed to the keenest competition in the imports of goods needed for Indian industries. For example, in 1935-36 German imports of hardware increased by Rs. 13 lakhs, of dyestuffs by Rs. 11 lakhs, of steel tubes by Rs. 25 lakhs and of electrical instruments by Rs. 6 lakhs. In addition German machinery, electrical material, motor vehicles, etc., were imported on the basis of barter arrangement with Indian States and private firms.

The broad fact which emerges from a study of these trends of trade is that the protective and stimulating effects of the Ottawa preferences upon the trade balance between India and the United Kingdom were largely neutralized by other factors in the situation. At best these preferences had a negative value for the United Kingdom in so far as, in the absence of preference, she would have lost heavily under valuable heads of trade, such as hardware, chemicals, non-ferrous metals, appliances and apparatus, cycles, paints, etc., in which continental competition was particularly severe. Whether they had at least a negative value for India *also* is doubtful in view of the fact that the possibilities of a compensatory expansion of the demand for Indian exports in countries other than the United Kingdom which previously used to offer a very much wider market than the United Kingdom, were, in spite of the breakdown of the multilateral trading system, by no means so restricted as was supposed at that time. But the more important issue which was at stake was the restoration of equilibrium in India's balance of payments *vis-a-vis* the United Kingdom. The committee appointed by

the Indian Legislative Assembly to review the working of the Ottawa Agreement seemed to approve the Ottawa preferences on the ground that 'the general tendency of the mutual trade between India and U.K. has been, of recent years, towards an equality of exchanges which has practically been established in the first year of the preferences'. (In 1933-34 the value of Indian exports to U.K. had exactly balanced the value of British imports into India at Rs. 48 crores). The committee failed to see that there was no special virtue in 'equality of exchanges', so far as merchandise trade is concerned, between any two countries. India's balance of trade position required a movement of U.K.'s balance of trade with India in the direction of passivity. What the committee described as 'equality of exchanges' was, as subsequent events showed, only a stage in such a movement, and the culmination was India's large active balance of trade with the U.K. which was anything but 'equality of exchanges.' As things were, India had a passive balance of Rs. 5 crores in 1934-35 and of Rs. 2 crores in 1935-36 and thereafter an active balance which amounted to Rs. 16 crores in 1936-37 and Rs. 12 crores in 1937-38. The increasing passivity of the U.K.'s balance of trade with India which was required to meet payments on account of 'capital' and 'service' items in the balance of accounts was due as much to the failure of the Ottawa preferences to stimulate the importation of British goods into India as to the increase of Indian exports to the United Kingdom. Other factors in the situation remaining the same, if the Ottawa preferences had succeeded in bringing about an increase in British imports into India the movement of the United Kingdom's balance of trade with India in the direction of passivity would have been correspondingly counteracted, and *unless* there was a compensatory increase in India's active balance of trade with countries other than the U.K., India's balance of payments position would have deteriorated still further. But it is reasonable to presume that during the period under review increasing imports from these countries into a comparatively free market like India which offered most-favoured-nation treatment (if we leave out the system of empire preferences which proved a hindrance but not an insurmountable trade barrier like quotas, prohibitions, exchange-control devices and other current

CHAPTER 3

ALTERNATIVES OF COMMERCIAL POLICY

The broad objectives of policy which are designed to govern post-war trade relations have been set forth in the texts of the Atlantic Charter and the Master Lend-Lease Agreement, better known as the Mutual Aid Agreement. Clause 4 of the Atlantic Charter reads as follows :

'They (the United Kingdom and the United States) will endeavour, with due respect to their existing obligations, to further the enjoyment by all States, great or small, victor or vanquished, of access, on equal terms to the trade and to the raw materials of the world which are needed for their economic prosperity'.

Article VII of the Mutual Aid Agreement, which is more specific and objective in content, reads as follows :

'In the final determination of the benefits to be provided to the United States of America by the Government of the United Kingdom in return for aid furnished under the Act of Congress of 11 March, 1941, the terms and conditions thereof shall be such as not to burden commerce between the two countries, but to promote mutually advantageous economic relations between them and the betterment of world-wide economic relations. To that end, they shall include provision for agreed action by the United States of America and the United Kingdom, open to participation by all other countries of like mind, directed to the expansion by appropriate international and domestic measures, of production, employment and the exchange and consumption of goods, which are the material foundations of the liberty and welfare of all peoples; to the elimination of all forms of discriminatory treatment in international commerce, and to the reduction of tariffs and other trade barriers; and, in general, to the attainment of all the economic objectives set forth in the Joint Declaration made on 12 August, 1941, by the President of the United States of America and the Prime Minister of the United Kingdom'.

'At an early convenient date, conversations shall be begun between the two Governments with a view to determining, in the light of governing economic conditions, the best means of attaining the above stated objectives by their own agreed

action and of seeking the agreed action of other like-minded Governments'.

Master Lend-Lease Agreements in identical terms have been concluded by the United States of America with the Soviet Union, China, Belgium, Czechoslovakia, Ethiopia, Greece, Liberia, the Netherlands, Norway, Poland, and Yugoslavia. Australia and New Zealand have accepted the terms of the Agreements, and Canada has agreed to the principles set forth in Article VII.

Clause 4 of the Atlantic Charter envisages the restoration after the war of a world-wide trading system based on the principle of non-discrimination, subject, however, to the reservation that due allowance must be made for 'existing obligations' which, according to one authoritative interpretation, is not merely a vague saving clause, but refers to the preferential tariff arrangements within the British Empire and other tariff treaties based on reciprocity which may or may not be required in the future, but which could not be abrogated, so long as they are in force, by unilateral action. But this reservation has also been interpreted to mean that the Atlantic Charter has recognized the British Commonwealth of nations and the British Colonial Empire as a trading block which was free to organize itself on the basis of reciprocal tariff preference and subject the trade of the rest of the world to discriminatory treatment. How far this would be consistent with the main objective of restoring a worldwide trading system which will secure freedom of commercial access to raw materials is a debatable question. We must, however, emphasize what was explained in detail in chapter 2, viz., that it is not mere freedom of access to trade in a general sense but the building up of a multilateral trading system, which can effectively guarantee freedom of access to raw materials. Broadly, therefore, Clause 4 of the Atlantic Charter should be interpreted as setting forth the objective of a multilateral trading system the disintegration of which during the inter-war period was a fruitful cause of economic warfare and the general impoverishment of nations.

Article VII of the Mutual Aid Agreement is more specific in content and lays down the logical steps which, as the result of 'agreed action', would lead to the final goal of

multilateral trade. It is a matter of profound significance that the parties to the Mutual Aid Agreements should think it necessary to emphasize the crucial importance of international trade and trade policy in the sphere of international economic reconstruction. The language of Article VII, of course, implies that agreed action would also be clearly necessary in the field of monetary stabilization and international investment. But, as explained in the last chapter, stabilization of world currencies presupposes freedom of convertibility of every currency into other currencies at non-discriminatory rates of exchange, which again implies a régime of non-discriminatory multilateral exchange of goods and services of which the currency operations are the counterpart. Similarly, as we have already seen, the movement of international investment, if the past offers any guidance for the future, is bound to be dovetailed into a system of multilateral trade and multilateral clearing of accounts. Hence it was very appropriate that the problem of restoring a multilateral trading system should have engrossed the attention of the United Nations as one of primary importance. But it is necessary to stress the elementary fact that trade, after all, is an ancillary economic process which should reflect a high level of employment and output and a general diffusion of increased well-being within the trading bodies. Naturally, therefore, there is clear enunciation in Article VII of the fundamentals of the post-war economic reconstruction which are summed up as 'the expansion, by appropriate international and domestic measures, of production, employment and the exchange and consumption of goods which are the material foundations of the liberty and welfare of all peoples'.[1] We also find a variant of such ultimate economic objectives in clause 5 of the Atlantic Charter, according to which Great Britain and the United States of America would seek international collaboration in the economic field with the object of securing for all nations 'improved labour standards, eco-

1. This is a conservative view of the economic goal as distinguished from the more liberal and attractive economic objective of Full Employment popularized by Lord Keynes and Sir William Beveridge.

nomic advancement and social security'. It should be noted that although the relevancy and appropriateness of both domestic and international measures required to achieve these great peace aims is clearly recognized, yet the limits of national economic planning could not be defined in a statement of broad principles, and it has been assumed that national economic planning would somehow be harmonized with an international economic order. But some of the specific international measures which must be taken to restore the multilateral trading system have been categorically mentioned in Article VII. First, there is the assurance that the terms and conditions of the repayment of the vast amount of aid received from the United States of America under the Lend-Lease Act would be such as not to 'burden the commerce' between the nations who have received such aid and the United States of America. Apart from the question of how far the vast Lend-Lease aid *should* be repayable in view of the partnership of the United Nations in a common war effort and *could* be repayable without burdening the commerce of nations, it was an act of economic statesmanship for the United States of America to recognize that a world trading system could not be launched on an even keel without this assurance. Indeed such an assurance was particularly needed as a minimum condition for the stability of Anglo-American trade after the war on which the economic recovery of a large part of the world will so largely depend. Both Great Britain and the United States of America constitute important markets. Either of them can, if she desires to do so, create price disequilibria between not only her own internal economy and the rest of the world, but also between markets largely dependent on her market and the rest of the world, thereby setting limits to the scope of multilateral trade. Hence for the 'betterment of world-wide economic relations' there must be co-ordination of the programmes of economic recovery ('domestic measures') in the two countries. This is not explicitly stated in Article VII. What is explicitly affirmed is that the post-war trade between the two countries should not be burdened by the repayment of a vast amount of Lend-Lease aid. It has been estimated that Great Britain would require an increase of exports by at least 50% after the war

to barely pay for her normal imports. Her overseas investments have been liquidated by as much as 50% and other future sources of income, for example, shipping, have also been probably reduced as the result of the war. Great Britain's balance of payments, according to many experts, will go so widely and intractably out of equilibrium after the war that there can be no question of the commerce between her and the United States being further burdened by the repayment of Lend-Lease aid. Secondly, Article VII specifies 'the elimination of all forms of discriminatory treatment in international commerce' and 'the reduction of tariffs and other trade barriers'. Realization of the necessity for such action has grown out of the tragic experience of the inter-war period. How far discriminatory and bargaining tariffs and rising trade barriers could be held responsible for the last economic depression, is a question on which opinions would differ according to the predilections of both economists and politicians. But there is no doubt that the 'beggar-my-neighbour' policy pursued by nations, the attempt to seek an overseas market while erecting a tariff barrier against foreign imports, the frantic effort to deflect the economic depression to the weakest economies and to use tariff bargaining and discrimination as an instrument of economic warfare and power economics in such a way as to make the economies (and also the politics) of the weaker States complementary and subservient to those of the powerful States, were policies calculated to shatter the foundations of world economy and of world peace. Hence the enlightened self-interest of nations demands that in the common interests of peace and economic recovery after the war the instruments of aggressive economic nationalism should be discarded by common consent.

The texts which we have briefly analysed and interpreted bear a family likeness to many which were issued from time to time during the inter-war period by responsible international bodies under the signature of responsible statesmen.[2]

2. One remembers in this connexion the fate of the third of President Wilson's famous fourteen points which called for the removal so far as possible of all economic barriers and the establishment of an equality of trade conditions among all the nations consenting to the

In the past such statements have often had an atmosphere of unreality about them. In a recent publication of the League of Nations the character of the recommendations of international conferences on trade policy in the 'twenties has been described as follows:

> 'They were frequently little more than formulae representing a compromise between divergent or even conflicting opinions; they frequently concealed fundamentally incompatible aims and irreconcilable interests of principal economic powers in the matters of tariff policy; they were accepted by delegates and governments with every variety of mental reservation as to their practical applicability. They did not bind governments to specific acts of policy, nor were the governments which endorsed them always competent to take the necessary decisions'.[3]

Reading between the lines of the texts which we have been discussing one wonders whether these remarks are not also applicable to them. Access to trade and essential raw materials on equal terms for all nations is qualified in the Atlantic charter by the vague reservation 'with due respect to their existing obligations'. This is, as we have explained, a concession in favour of the system of preferential tariff within the British Commonwealth and the Empire. But both the United States of America and the United Kingdom apparently have conflicting opinions on the possibility of harmonizing full employment and economic stability within the Commonwealth and the Empire with the realization of similar economic objectives in the rest of the world. Again, different nations in special circumstances may have different conceptions of the nature and scope of 'appropriate domestic measures' which may be adopted to achieve 'expansion of production, employment, the exchange and consumption of goods', or what is popularly described as 'full employment'. In times of rapid economic change and uncertainty when the recovery programmes of the great States are not co-ordinated and their economic growth and expansion are proceeding at

Peace. This was toned down into a weak, equivocal injunction in the covenant, viz., 'equitable treatment of commerce'!

3. *Commercial Policy in the Interwar Period* (1942) p. 153.

an unequal pace there would be a danger of their domestic economic policies aimed at full employment running counter to 'international measures' which are considered as appropriate to the progress of the rest of the world towards full employment. Uncoordinated national recovery programmes of great States are likely to involve a chaos in trade relations and economic relations in general, and are bound to lead to this result if severe trade restrictions are used as instruments of economic reconstruction. On the contrary, those who believe in national economic planning (in Great Britain, for example) have been arguing with considerable ingenuity that exchange control, quota restrictions, State trading and even discriminatory treatment of trade should not be altogether banned but must be judged on their merits, and the test should be whether they contribute to the expansion and stability of trade and employment in the world as a whole. Furthermore, the powerful tradition of high tariffs in the United States of America, notwithstanding her rôle as a great creditor nation after the last war, has given rise to serious misgivings about the prospects of liberalization of world trade. Clause 4 of the Atlantic Charter was a repudiation of restrictions upon the quantity of world trade. In itself it was not a repudiation of tariffs which are claimed to be the instruments of what has been called the 'Old Protectionism'. Tariffs do restrict trade, and so the decision to 'reduce tariffs' in terms of Article VII of the Mutual Aid Agreement is really the spearhead of an approach to freer trading opportunities. But even during the classical period of freest trade before the last war there were high tariffs in all countries except Great Britain. And it was only when the United States of America while pursuing the policy of high protection increasingly became the world's foremost creditor that quantitative restriction of trade by tariffs became disastrous. There is no doubt that 'New Protectionism' represented by discriminatory rationing of imports by quotas, discriminatory exchange control, etc, is a menace which should be resolutely fought, but success will depend not upon mere repudiation of 'New Protectionism', but upon the extent to which the level of American tariffs could be reduced after the war consistently with the position of the United States of America as a great creditor nation. It is felt

that there are formidable domestic difficulties both in the United States of America and the United Kingdom in the way of implementing the decision to reduce tariffs after the war. Vested economic interests have entrenched themselves in protected industries, and they would not be willing to face heavy transitional losses which freer trading conditions would involve. Moreover, even if trade restrictions imposed by the larger States are swept away restrictions imposed by private international cartels on trade and access to raw materials would constitute a formidable problem as compared to which the question of governmental tariff policy will pale into insignificance.

Doubts and misgivings, mental reservation and conflict of opinion which seem to dominate current thinking on fiscal policy have their roots, if our analysis is correct, in the realization of the fact that the problem of reconciling national economic planning with a free flow of international trade and international investment has not so far been satisfactorily tackled. Keynes says that national economic planning is not necessarily incompatible with international co-operation in the field of trade and international investment.

> 'If nations can learn', he says, 'to provide themselves with full employment by their domestic policy there need be no important forces calculated to set the interest of one country against that of its neighbours. There would still be room for the international division of labour and for international lending in *appropriate* conditions'.

On the other hand, if foreign trade becomes 'a desperate expedient to maintain employment at home by forcing sales on foreign markets and restricting purchases', it will, if successful, 'shift the problem of unemployment to the neighbour which is worsted in the struggle'.[4] The 'appropriate conditions' under which national planning can be compatible with the free flow of international trade and investment will have to be created by international action. Co-ordination of the recovery programmes of the larger States is, as already

4. *The General Theory of Employment. Interest and Money*, pp. 382-83. The italics are mine.

explained, a primary condition. Planned investment of capital for purposes of economic reconstruction in countries devastated by the war and for economic development in backward areas is another condition. Otherwise if most of the countries which have been devastated by the war (in Asia as well as in Europe) do not know how their industrial organization is to hang together after the war, if they find the world markets disorganized, if they find the cost of creating an export market prohibitive and if they lack capital to reorganize their economic life, they will inevitably, if they are free to do so, develop a defensive attitude to foreign trade and try to secure at least the home market to their industries. The economically backward countries, specially those who have experienced severe economic isolation during the war, will also behave in a similar manner. On the other hand, world trade is more likely to be promoted if the economic structure and needs of these countries are carefully considered, so that tariffs essential for economic development are permitted, while those which raise domestic costs without long-run benefits in the general interest may be lowered. Moreover, there must be an international monetary organization which should help nations to maintain equilibrium between the debits and credits of each in terms of commercial and other transactions. When the wages and price levels in a certain country in terms of money are out of line with those elsewhere, a change in the rate of its foreign exchange is inevitable. The function of the international monetary organization would be to give time and opportunity for adjustments to be made between national policies and world conditions. In the absence of such an organization a country faced with serious disequilibrium in its balance of payments will try to maintain domestic employment by imposing quantitative restrictions on trade and practising exchange control. There is little evidence to show that these basic conditions under which national economic planning would cease to be restrictive of world trade have a fair chance of coming into existence in the period of transition following the end of the war. Hence all countries impoverished by the war which are free to direct their economic life have been inclined to show a defensive attitude to foreign trade because they sense the danger of the stronger

States 'shifting the problem of unemployment to the weaker ones'.

The restoration of multilateral trade and the liberalization of trade policy represent a broad economic strategy. But national economic policies after the war will be concerned, as in the 'thirties, with the 'determination of immediate tactics rather than with the formulation of a broad strategy'.[5] General theories and principles of economic policy which are stated in absolute terms usually relate to the 'long period' and appear unreal in their application to the problems of the short period. The same seems to have already been the fate of the broad liberal principles of trade embodied in the Atlantic Charter and the Mutual Aid Agreement. It is true that the affirmation of these principles with a clear consciousness of their implications and earnest determination to follow their logic would shorten the period of transition to the long-range objective. But there is accumulating evidence that the immediate short-period tactics of national economic policies have won the day. The decisions of the Bretton Woods Conference on the international monetary system throw a flood of light on the pattern of short-period trade policy which is likely to emerge. It will be remembered that originally both the Keynes (British) and White (American) currency plans aimed at a currency system which would be international and multilateral in its working. Both Keynes and White were anxious to avoid the strictly bilateral adjustment of trade. Both wanted some machinery to maintain an international equilibruim of costs and prices either by directing changes in exchange parities, or by inducing the nations to correct deviations of their internal economies from international equilibrium. For preserving equilibrium in the balances of payments both of them contemplated control of capital movements (particularly short-term) and a system of international credits—clearing overdrafts—with a fixed ceiling, and also insisted that 'surplus' nations should either accept goods and services of debtors (to avoid transfer difficulties)

5. *Commercial Policy in the Inter-war Period* (League of Nations 1942) p. 154.

in return, or reinvest their balances in such a way as to produce means of repayment. While there was so much of substantial agreement on the general objectives (as there is agreement on the objective of non-discriminatory, multilateral trade and free trading opportunites), there was sharp divergence of opinion on the methods of achieving them. While the White plan was conceived on the basis of the traditional liberal economic principle of world economy with its insistence on the discipline of the international gold standard and freedom of trade, the Keynes plan was conceived in the light of the 'closed economy' principle which emphasized the bearing of national economic planning on domestic employment, trade balances and capital movements. But in the heat of the controversy it was gradually realized that a long-range plan of currency stabilization and settlement of trade balances was foredoomed to failure if it sought to tackle the transitional problems of currency and trade in the period following the end of hostilities. White had assumed for the success of his plan that post-war disequilibrium in prices and costs and in the balances of payments would be short-lived (four or five years), and that within this short period freedom of foreign payment (free multilateral convertibility of currencies which presupposes comparative freedom of multilateral trade) would be restored, and the balances of payments of nations, severally and collectively, would be either in equilibrium, or so close to it that they could be brought to it by quite minor adjustments. Keynes was realistic enough to emphasize that the long-range plan which White had in mind would hardly meet the requirements of the acute post-war situation in Great Britain and many other countries. While, therefore, the White Plan sought to ban exchange control, Keynes insisted that nations must be left reasonably free to control foreign exchange and capital movements and to form currency blocks. American opinion has ultimately veered round to the view that since the period of transition may be longer than was imagined, and disequilibrium will be at its maximum during this period, it would not be wise to burden the system of international clearing with the demand made upon it by the settlement of abnormal war balances, specially when one takes into account the abnormal demand for dollars from the

rest of the world which may be too heavy to be reasonably met. Hence the currency plan which was eventually accepted at the Bretton Woods Conference has been made definitely inapplicable to the possible requirements of the period of transition from war to peace during which member nations will have freedom of adjustment through war-time economic controls. The questions of 'abnormal war balances' (India's sterling balances, for example), inter-Allied indebtedness, revision of tariffs and opening up the channels of trade will be settled irrespectively of the long-range currency plan. The White plan looked askance at devaluation or depreciation of currency and treated them as abnormal currency practices which should be discouraged. But the Bretton Woods scheme provides for alteration (up to 20 per cent) of the par values of currencies at the request of member countries, if it were essential to correct a fundamental disequilibrium in the balance of payments arising from 'domestic, social or political policies of the country applying for a change of parity'. Moreover, 'during the post-war transition period member countries would be permitted to retain their exchange controls with the expectation that they would be relaxed gradually'. But the Fund's approval will have to be obtained for restrictions on payments for current international transactions, discriminatory currency arrangements or multiple currency practices. The system of exchange control and sterling clearing, which embraces what is called the Sterling Area, has been definitely recognized. The Empire Dollar Pool will also be available after the war to maintain equilibrium in the dollar-sterling exchange. The same object will be served by the provision that when a currency becomes scarce (the dollar, for example, which every nation will demand after the war) the International Monetary Fund 'will make recommendations designed to increase the supplies of such currency', but that, meanwhile, after consulting the Fund, member States would be allowed to impose exchange restrictions in respect of the scarce currency. It is quite clear that the economic tactics of the 'thirties which were aimed at fighting deflation and fall of employment in various countries have won international recognition. But so far the important difference seems to be that the employment of some of these tactics may be subject

to international supervision and control. One may only hope that the history of the 'thirties will not repeat itself, that *all* nations would succeed in planning a high level of employment and income, and that the economic recovery programmes of different countries would be co-ordinated in the interests of the world economy as a whole.

While it is certain that post-war trade policy will be moulded by the exigencies of the immediate economic tactics of national economic planning, yet these tactics are bound to evolve within the pattern of the broad strategy of non-discriminatory, multilateral trade. The necessity of multilateral trade is simple. So long as there is diversity of economic resources located in different national areas and capital investments are distributed in different sections of the world economy, there must be indirect channels of transfer of goods and debt services through multilateral trade. It has been argued that the growth of war-time industries, such as manufactures of synthetic fibres, synthetic rubber and plastics will lessen the need for multilateral trade. But apart from the fact that these are high-cost substitutes and can be produced only in highly industrialized countries, the sheer necessity of repairing war damage, of re-stocking and re-equipment of industries, and of using the tremendous industrial potential which has developed in the course of the war, will give an amazing impetus to international trade. Multilateral trade which suffered serious disintegration in the 'thirties was never completely wrecked, as the analysis contained in the last chapter has shown. It is bound to be restored after the war, although the indirect transfer routes have been blocked during the war. But it should not be imagined that its pattern will be the same as it was before the war. As Mr. Hilgerdt says, multilateral trade as such should be distinguished from the multilateral trading system which developed as a long process over time and was gradually adapted to the changing economic structures of nations and their changing requirements of one another's goods and services. The end of the war will witness widespread reshuffling of industries and occupations not only in countries in which industrial equipment has been destroyed, but also in countries which will emerge from the war with increased industrial capacity. Changes in technique

and particularly the up-grading of labour will have profound effects upon the industries of these countries, and will have an important bearing upon specialization of labour in different countries and their demand for one another's products and services. Thus the multilateral trading system will develop into a self-adjusting mechanism only when the transitional changes in the economies of the various countries have been completed. But the dynamics of the process of development of this system is likely to be the same as it was before the last war. The analysis contained in the last chapter has shown that the momentum to the expansion of world trade as well as to the development of the multilateral trading system (which went hand in hand) was supplied by two important interlacing economic forces:—(i) Unequal pace of economic growth in different parts of the world, and (ii) investment of capital by richer countries in economically backward areas. The latter was an economic force which activated backward economies. But it was the disparity of economic development in agricultural and industrial countries which gave rise to trade that was bilateral to start with, but eventually became triangular and multilateral in course of time when countries like Germany and the United States of America rose as industrial nations and it became possible for Great Britain, a great creditor nation at that time, to collect her interest and dividends not in the form of net import of commodities from the debtor countries directly, but indirectly in the form of net import of commodities from Germany or the United States of America, who, in their turn, had a net import from the debtor countries concerned. Gradually other nations which made economic progress took their places along the different transfer routes with Great Britain as a terminal point. After the war the development of a new system of multilateral trade will have the momentum of both unequal pace of economic development and international investment of capital in 'capital-hungry' areas. The United States of America which will emerge from the war as the greatest creditor nation in history, with a vastly expanded productive capacity, is very likely to use foreign lending as a powerful lever with which to activate her own foreign trade and, with it, the world trade as well. She may thus become a terminal

point in the various transfer routes—an activating centre which will dominate world trade. On the other hand, although Great Britain may not play her accustomed rôle as a creditor nation after the war, yet she can still function as an activating centre of trade through a judicious use of the liquidation of large blocked balances, of her large consuming capacity, of her trade connexions, and of her financial and political ties. The network of trading relations which will emanate from the recovery programmes of these two dominant nations will not assume a widespread multilateral character during the transitional period. And it is very probable that international trade after the war will restart on a bilateral or triangular footing and evolve into multiangular trade within distinct trade blocks before it can finally develop into a world-wide trading system. The Sterling Bloc, which has already been recognized at Bretton Woods and has been operating during the war on the basis of centralized control of sterling transactions and pooling of the dollar receipts of the empire countries, will have little utility unless it also becomes an important trade block immediately after the war. And the probability of its being so would be increased if and when the British Commonwealth and the Empire find it worth their while after the war to adhere to the preferential tariff arrangements which are in force. But without the stabilization of the trade relations between the United States of America and Great Britain (on which the stability and alignment of the dollar-sterling rate, the sheet-anchor of the world's currencies, will ultimately depend) there can be little hope of economic rehabilitation in a large part of the world.[6] Hence

6. We have to leave out of account the rôle of Soviet Russia in the rehabilitation of world trade, because we do not frankly know how the state-controlled economy of this country is likely to fit into the framework of world trade. Soviet Russia is not expected to be a capital-exporting country in the immediate post-war period. But this country may spring yet other surprises on the world, and may play a world rôle in the sphere of trade. Her great wealth of natural resources would put her in a better position to practise a policy of economic autarchy. But the rebuilding of Russian industries side by side with the continuance of industrialization and the raising of the standard of living will induce Russian leaders to participate in world

before we are in a position to lay down the general lines of India's trade policy in the post-war period on the basis of the objective analysis contained in this as well as in the previous chapter—though an intelligent reader, who realizes that the traditional doctrines of free trade and autarchy have been worn rather threadbare, must have guessed what India's trade policy should be like—we must obtain a more clear picture of how Great Britain and the United States of America are likely to develop their trade relations between themselves and with the rest of the world. Here we are more or less in the region of conjecture. But coming economic events cast their shadows before, because they are rooted in the facts of the economic situation which are already recognized by responsible men and have been influencing economic opinion on trade policy in the two countries. The main facts will now be briefly summarized to form the basis of intelligent anticipation which is the essence of economic planning. 'To be forewarned is to be forearmed', and those responsible for planning India's trade policy will have to particularly remember this simple adage.

A frank and objective study of the position of the United States of America in the world economy in the post-war period was presented two years ago by Hal. B. Lary and associates in *'The United States in the World Economy'*, published by the United States Bureau of Foreign and Domestic Commerce. According to the authors of this book, after the war both the exports and imports of the United States of America 'will increase in total value as compared with their pre-war levels, but the forces stimulating exports will be different from, and stronger than, those determining

trade. The adherence of Soviet Russia to the Mutual Aid Agreement is a significant pointer. State trading will undoubtedly increase the bargaining power of Russian trade missions, and it will be easy for competitors in free market economies to raise the cry of Russian dumping specially because the prices of Russian exports will not be governed by the ordinary criteria of costs applicable to goods produced in free market economies. How trade policy will adapt itself to trade with Soviet Russia is an unsolved problem.

imports'. Even if full employment is attained in America 'the resulting stimulus to imports should not be exaggerated'. American exports which consist largely of 'high-standard-of-living goods' will attract a still more rapidly growing volume of foreign purchases. Imports of certain finished manufactures may increase in a period of rising prosperity in America, but they form a minor part of the total, and their 'variety has been severely limited by the protective tariff'. Under the head of services and invisible trade generally the balance is expected to shift sharply in favour of the U.S.A. except in so far as there will be substantial American grants to other countries for purposes of relief. Thus, other things being equal, the shortage of dollars which caused serious dislocation of trade in the 'thirties will be intensified after the war. When we take into account the large sums which many nations must spend in America to buy the means of carrying through the programmes of reconstruction and development according to their basic needs and legitimate aspirations, the problem of the dollar begins to assume serious proportions. The authors of this book indicate two lines of policy which must be pursued by the U.S.A. 'one way (to make available a larger and more stable supply of dollars) is by a renewed outflow of American capital, and the other is by positive measures to permit a large volume of imports'.

First, let us briefly consider the vexed question of American tariffs. There is a section of opinion in the U.S.A. according to which the wide fluctuations in domestic economic activity and world prices have been of greater consequence in determining the volume of imports into the U.S.A. than changes in the tariff rates. But the tariff policy apart, a country which needs so little from the rest of the world but from which the rest of the world needs so much, cannot contribute to the stability of world trade. American statesmen have long realized this basic fact, and have decided that reduction of tariffs is a necessary condition under which this economic anomaly can be rectified.

'The real explanation of the United States Tariff of 1930, as well as that of 1922, would seem to lie in the existence of deep suspicion of import trade as an element of disturbance

and depression and a belief in the beneficial effects of economic isolation'.[7]

The economic isolationism of the United States of America is likely to share the same fate as her political isolationism. Hence American economic opinion should be inclined to favour a gradual lowering of the high American tariffs. In fact a broader view of America's rôle in the world economy was taken as early as 1934 when the initiation of the Hull Trade Agreement programme marked a reversal of the American tariff policy. Before 1934 the United States had an autonomous, non-negotiable tariff with high rates of duty. While she refused to reduce her own very high tariff by negotiation, she claimed the benefit of any tariff reduction negotiated between European countries through the operation of the Most Favoured Nation Clause. The consequence was that the Clause itself was discredited, and there was natural reluctance to make reciprocal tariff concessions which would be 'generalized' by it to the benefit of one of the greatest exporting countries which shut out the goods of other countries by high tariffs. There was thus no chance of a general reduction of tariffs in different countries. Under the Reciprocal Trade Agreements Act of 1934 the American tariff became negotiable, and the President had the power to modify the rates of tariff (fixed by Congress) by tariff bargaining.[8] Isolationism in the sphere of trade policy was broken. The long upward trend of American tariffs was checked, and in a few of the more important agreements striking reductions were made on both sides. But in the opinion of Percy W. Bidwell the effect of these agreements on foreign tariffs has been limited; they have been effective in stimulating America's exports, but their effect on her import trade seems to have been negligible. According to him, 'the Hull Trade Agreements programme offers no adequate means of

7. *Commercial Policy in the Inter-war Period* (League of Nations) p. 126.

8. The Reciprocal Trade Agreement has recently been extended for another period of three years. The Administration has the power to reduce duties by 50 per cent.

accomplishing on a sufficient scale the cut in American import duties'.[9] Tariff bargaining has also been a slow process. Up to 1944 only thirty agreements have been concluded. Every country has preferred to await the results of bargaining with other countries, because, owing to the practice of generalization of concessions, by waiting it might secure them for nothing. It is doubtful whether such a dilatory procedure of tariff reduction can meet the requirements of world trade.

The second method of adjustment by which trade relations of the U.S.A. with the rest of the world can be stabilized is export of capital. This method is likely to appeal more to a great creditor nation. The war has demonstrated how full employment in the U.S.A. could be combined with the release of a colossal amount of Lend-Lease supplies flowing to all quarters of the globe. It will not be surprising if the Americans apply the lesson of this experience to their peacetime problems of trade. Foreign lending through the process of creating an export surplus can maintain full employment in the U.S.A. without expensive public works and without interference with the internal distribution of wealth, and at the same time she can acquire foreign assets on a large scale. Hence the theory which has been taking shape in the U.S.A. is that after the war she must lend abroad continuously until productivity in other countries including undeveloped nations has increased up to the point at which the demand for the lender's goods is reduced in intensity and the creditor country can have a balanced current-account position. As Mr. Harry Hopkins, Personal Adviser to the late President Roosevelt, said in 1944 in the course of an article published in an American magazine, even when the U.S.A. lowers her trade barriers and purchases more of the goods supplied by debtor countries, the latter could not pay the former currently for the equipment and materials the debtor countries would need for their rehabilitation. Therefore, Mr. Hopkins added: 'We shall have to make further loans abroad in order that other countries may have the capacity to buy our goods and equipment'. The reactions to the possibility of America's

9. *American Economic Review*, March 1944 Supplement, pp. 344-345.

'capitalistic penetration' into world markets have naturally been unfavourable in Great Britain. It has been estimated that the world's unfavourable balances of payments will, in the absence of restrictive devices, be of the order of 5 billion dollars a year. 'After the immediate relief period is over the annual deficit in a reasonably free market would rise from the half-billion of the 1930's to a billion and half dollars in the late 1940's and 1950's. This is a large sum to be lent internationally'.[10] Secondly, loans have ultimately to be repaid in goods and services, and it is asked, 'what products are there which the world, with the aid of American capital, can put itself in a position to sell in larger quantities on the American market ?'[11] Lastly, it is argued that loans can close the gap in the balance of payments of Great Britain if they are not spent by her on additional American goods. But there is a tendency in the U.S.A. to favour loans with a 'tie-up' clause. It must, however, be pointed out that the 'tie-up' clause will not be unwelcome to undeveloped countries which want to rehabilitate or redevelop their internal economies with American capital.

The British conception of post-war trade policy has recently crystallized into a set of ideas which are very far removed from the traditional doctrine of free trade, but which are realistic enough to appeal to nations that would be in the same predicament as Great Britain after the war. These ideas were powerfully expressed in a series of articles entitled 'Principles of Trade' and published in the *Economist* in January and February 1944. The leading ideas may be summarized in fairly simple terms. The British problem after the war will be to find the means of paying for her imports. Great Britain will emerge from the war with her foreign assets substantially depleted and her merchant marine severely reduced in size. The loss of invisible exports will create a gap of £200 million on the credit side of the balance of payments. The alternative methods of maintaining equilibrium in the balance of payments would be (1) decrease of imports,

10. *The Economist* (London) 29 January, 1944.
11. *The Economist* (London) 4 December, 1943.

(2) borrowing and (3) expansion of exports. The restriction of imports would be neither possible nor desirable. In 1938 food, materials and oils constituted 80 per cent of British imports, and none of these were 'non-essential' imports. Moreover, the restriction of imports would mean a sharp reduction of the standard of living. In fact, if reasonably full employment were to be maintained the volume of consumption and, therefore, of imports, will rise above the pre-war level. In other words, the gap on the credit side of the national account will become wider still. The second alternative of foreign borrowing of the magnitude required to maintain equilibrium in the balance of payments has to be rejected for reasons explained above. The only practicable alternative for Great Britain is to expand her exports by about 50 to 60 per cent if she were to implement her programme of full employment and social security. It is no doubt recognized that multilateralism would serve the interests of both Great Britain and the United States of America, because the wider the range of trade the greater the gain. On the other hand, bilateral arrangements are characterized by discrimination and pull of sectional interests. But British economic opinion does not recognize that the balancing forces operating under liberal trading conditions, the orthodox methods of adjustment, will provide a satisfactory solution of Great Britain's difficulties. One of the orthodox methods suggested is devaluation of the pound, which is expected to stimulate exports. But this is not favoured, because in a sellers' market the advantage will be with the sellers of primary products, and devaluation will do more harm than good by making imports expensive and thereby raising the cost of living and internal costs in general. The orthodox method of adjustment, when Great Britain will be threatened with a negative or unfavourable balance of payments after the war, is the restoration of equilibrium in the balance of payments by the contractionist process of cutting down the excessive side of the balance. 'But what full employment requires of foreign trade is that a country's imports and exports should be balanced at a high level'. This means that equilibrium in the balance of payments must be restored not by reducing the excessive side of the balance, but by extending the deficient side (exports). It is this

'upward balancing' which can achieve the combined objective of maximum trade and maximum employment.[12] But such upward balancing, so the argument runs, is not possible under the *laissez faire* conditions. If the responsibility for balancing the accounts is thrown upon the creditor who can balance them upwards by absorbing increased imports from the debtor country there can be a solution. But the United States of America will rather forgo her favourable balance in relation to Great Britain than encourage British imports. There can also be an upward balancing of British exports and imports if the proceeds of American loans granted to countries which require them for reconstruction or industrialization (for example, India, China and European countries) are spent in Great Britain. But the United States of America will not support the idea of her not being allowed to export capital goods; the 'tie-up' clause in American loan contracts is designed to prevent this from happening. Hence the final conclusion to which this long chain of reasoning leads is that Great Britain (and for the matter of that any other country in her position) must seek a solution which is 'less than universal, less than fully multilateral, less than completely orthodox'. In concrete terms this means what has been described as the regional solution. The Sterling Area, according to the *Economist,* may constitute a trade block which should provide the minimum international division of labour that would be practicable after the war. The conditions under which such a nucleus of multilateral trade can be formed should be as follows :—(1) the accounts of each member of the group with the other members taken together would have to be substantially balanced; (2) they must co-operate in removing disequilibrium by 'upward balancing', i.e., the

12. It is argued in this connexion that if internal economic expansion in a certain country leads to fuller employment and if increased consumption resulting from it stimulates imports without increasing exports, the adverse balance of trade will represent 'so much wastage to the full employment programme' and should be corrected by quantitative regulation of imports. Otherwise the country will sink into depression, and the loss of trade to the rest of the world would be much greater.

unfavourable balance of payments must be corrected by absorbing increasing imports from the country which has an unfavourable balance; (3) members must avoid large-scale depressions within their borders; (4) exchange control should be banned and quantitative restrictions minimized; (5) membership should be open to those nations who are willing to comply with these conditions; (6) the trade between this group and the United States of America should not be subject to differential restrictions except such as can be clearly shown to arise out of a shortage of dollars. Another variant of the same conception of a regional trade block which has perhaps a greater appeal to the British nation is the idea of a trade block embracing the British Commonwealth and the colonial empire which would be organized on the basis of preferential tariff arrangements. Mr. Ernest Bevin, while outlining the Labour policy at Blackpool on 23 May 1945, said:

'Britain must harmonize her position as an importing country with the growth of organized sales methods, and that Labour would be willing to reconsider the problem of empire preference if there were a general lowering of tariffs in the world and if the Dominions are with them. Otherwise preference must be maintained'.

If this is the authoritative view of the British Labour Party, which is supposed to reflect progressive opinion, one can understand which way the wind is blowing.

The entire British attitude to trade policy, on final analysis, rests upon the certainty of scarcity of dollars immediately after the war. But it is forgotten that there has been a transformation of the U.S.A.'s balance of payments position during the last four years. On the eve of the Pearl Harbour the total known gold stock of the rest of the world was 8·7 billion dollars of which one-fourth was under earmark in the U.S.A. In September 1944 gold under earmark in the U.S.A. was 3·8 billion dollars, while the U.S.A.'s own stock was 20·8 billion dollars. Before Pearl Harbour foreign holdings in the U.S.A. were being reduced through war purchases. But when the U.S.A. entered the war she made large purchases abroad and relieved her allies of dollar shortage through Lend-Lease transactions. In this

way dollars began to pile up in foreign countries. Foreign-owned gold stocks and dollar assets increased by 1·6 billion dollars in 1942, by 2·8 billion dollars in 1943, and by 2·3 billion dollars in 1944. The rate of increase has been falling off. Similarly the negative balance of American cash expenditure, which rose from 760 million dollars in 1943 to 900 million dollars in 1944, has also been falling. But the result has been remarkable. Thus while in 1939 on short-term and long-term investments, the U.S.A. was a net creditor to the extent of about 1·8 billion dollars, in September 1944 she was a net debtor to the extent of 1·2 billion dollars. On 13 May 1945 *Reuter* reported from Washington:

'The rise in gold and dollar reserves of countries outside the United States may be an important factor in world stability, if the position of foreign countries is further strengthened by the adoption of the proposal agreed to by the United States Federal Reserve Board. The rise is estimated at from 7,000 million dollars in 1928 to 17,500 million dollars in 1944'.

The position was clarified further by an A.P.A. message from Washington, dated 2 July 1945 which ran as follows:

'President Truman has signed legislation reducing the required gold reserve of the U.S. Federal Reserve Bank to 25 per cent of deposits and Federal Reserve notes in circulation. Previously gold reserves equal to 35 per cent of deposits and 40 per cent of notes in circulation were required. The new law was asked for by the Bank with the explanation that reserves had shrunk as the result of American purchases abroad, largely paid for in gold, while U.S.A. exports were chiefly under lend-lease which brought in no return flow of the yellow metal'.

There is no doubt that the accumulation of gold and dollars in countries other than the U.S.A. will be a welcome buffer in the transition period. The long-range problem of dollar shortage remains, but no useful purpose is served by creating a scare of the acute scarcity of dollars immediately after the war.

Whatever the theoretical merits of the British case for the regional solution of Britain's trade problems, Great Britain already seems to be intent on building up a basis of

trade within the Sterling Area. The recent Turkish Trade and Payments Agreement which is generally the same as Britain's similar agreements with Sweden, Belgium, etc., provides that the Turkish Central Bank shall publish the buying and selling rates for sterling against Turkish pounds and the premium applied to certain transactions. Since early 1940 remittances between Britain and Turkey have been conducted through the Anglo-Turkish clearing at the pegged rate of 5·2 Turkish pounds per pound sterling, but future payments will be made through 'Turkish Accounts' at the Bank of England. Any Turkish holdings at the Bank of England can be freely transferred within the Sterling Area. This will create conditions favourable for multilateral trade within the Sterling Area. There is the usual 'multilateral aspiration clause', viz., that, as 'opportunity offers', the Bank of England will endeavour to make Turkey's sterling balances convertible into non-sterling currencies. The most important clause is that the British Government 'will do their best, having regard to the export situation, to satisfy Turkey's internal industrial and economic requirements and, having regard to Britain's general import situation, to grant facilities for importation of Turkish goods into Britain'. It need hardly be emphasized that agreements of this type, and particularly the clause just quoted, have indirect significance for other countries which contemplate buying manufactured goods from Great Britain or selling primary products to her. They clearly indicate an important trend of Britain's trade policy.

The American reaction to this phase of the British trade policy has not been naturally favourable. American traders have been resenting the fact that British trade has already established a firm foothold in Turkey, in the Middle East and in Latin America. But the acquisition of gold and dollar resources by countries other than the U.S.A. will have the effect of stimulating American exports after the war. In fact the financial arrangement which has made the accumulation of gold and dollars overseas possible is a bold stroke of economic policy directed to the stabilization of American economy. America's export surplus is equivalent to investment. Its disappearance or serious reduction would set up a deflationary impulse in her internal economy which she

must try to avert at all costs. Hence it is natural to expect that America will create an export surplus through the process of foreign loans (containing a 'tie-up' clause) being granted to numerous 'capital-hungry' nations. It is interesting to speculate how far foreign lending is likely to strengthen the position of the U.S.A. and undermine that of a rival trade block of industrial countries. If American capital raises the economic level of undeveloped countries the rise in the national incomes of these countries would increase the prices of agricultural or other primary products, so that the terms of trade of the rival trade block with these primary countries will worsen. The terms will worsen still further because of the increased competition of American manufactures with exports coming from the rival block, and also because of increased industrial capacity in the primary countries. But in the long run world employment and demand will increase as the result of American investment, and the rival block will gain thereby. Moreover, in spite of the increasing absorption of primary products in the primary countries (owing to industrial development) their standard of living will not rise so rapidly as to make the market of the rival block as of no importance. But it is possible to visualize circumstances in which the position of the rival trade block may be permanently threatened by American investment. Suppose that American loans are granted to *undeveloped countries* like China, Latin America, South-East Asia (A) on the condition that they must purchase the produce of *countries outside the discriminating trade block* (B) which have hitherto been selling their goods to the *discriminating trade block* (C). At the same time let us suppose that the U.S.A. grants attractive loans to B in the form of goods which B has hitherto bought from C. In these circumstances the position of the discriminating trade block may be undermined not only in the short period but also permanently. Loans will open up new channels of American export trade because of the new business connexions which they will set up, and a new structure of multilateral trade—in the extreme case outside the range of influence of the discriminating trade block—will come into existence. The only effective measures of self-defence open to the discriminating trade block would

be (1) to embrace as many countries as possible in order to strengthen its bargaining power and make itself less dependent upon external supplies; (2) to conclude long-term, reciprocal bulk-purchase agreements to wean away countries producing raw materials from the dominant influence of a pan-American trade block; and (3) to combine offers of loans with bulk-purchase contracts.[13]

It is more than a mere truism to say that Indian statesmen will have to steer a cautious course through these currents and cross-currents of economic policies in framing a suitable trade policy for this country. One initial advantage with which they will start is that India will be comparatively free to make the most of opportunities which may present themselves after the war to adapt her trade policy to the requirements of her domestic policy. Sir Jeremy Raisman, speaking in reply to the debate on the Finance Bill before the Legislative Assembly on 26 March 1945, disclosed that the question of India's entering into a Mutual Aid Agreement with the United States of America, confined at the time to the needs of the U.S. Forces in India, was discussed by the Government of India direct with the United States Government in January 1943. The vague implications of Article VII of the Agreement naturally made it difficult for the Government of India to understand its commitments as regards India's post-war tariff policy. 'India has always put forward the argument in regard to infant industries and the peculiar position of backward countries. It might well be that a formula which appeared to be *harmless* to other countries would have been embarrassing, if it had been subscribed to by the Government of India'.[14] The formula was obviously innocuous for Great Britain, for, as Sir Jeremy explained, 'although the Government of Great Britain signed that agreement, they did not consider themselves as being automatically precluded from, say, the continuance of imperial preferential

13. The author is deeply indebted for the theoretical model underlying his reasoning to Mr. T. Balogh's '*A Note on the Economics of Retaliation*', published in the *Review of Economic Studies* (Summer 1944).

14. The italics are mine.

tariffs clause thereby'. But since the 'Government of India found it difficult to obtain sufficient categorical indication of what the position would be, it was better to keep clear of any phraseology which might afterwards be thrown up against India in connexion with post-war fiscal policy'. The Government of India did make an attempt to 'detach the question of a signed agreement with the United States of America from certain implications of Article VII of the main Agreement'. But since the acceptance of the Agreement as a whole in identical terms was the spearhead of tariff reform in the opinion of the United States Government, and other countries had already subscribed to it, it could not be expected that Article VII would be reworded to suit the special circumstances of India. On the whole, there was no point in accepting Article VII with mental reservation, or trying to contract out of the implications of this Article by a suitable interpretation of its vague phraseology. Hence the Government of India followed a wise course in not signing the Mutual Aid Agreement and in preserving, to quote Sir Jeremy's words, 'the utmost liberty of action for its successors'. Apart from the fact that India would be free after the war from treaty entanglements and commitments, the reversal of the debtor-creditor relationship has increased her economic freedom and strengthened her bargaining power. India can now maintain her effective demand for foreign goods in spite of a possible reduction in the world demand for India's products. Since the pressure of the unilateral transfer of funds upon her export trade has now disappeared, there will be no violent alteration of the 'terms of trade' to her disadvantage in the event of an economic depression. It will now be easier for her to fight an economic depression with appropriate domestic measures and to adapt her foreign trade policy to the state of output, employment and prices within the country. But all these favourable factors have little significance *unless India is free to direct her commercial policy through a national government.*

The trend of the argument developed in this chapter, would clearly indicate that India should pursue the broad strategy of international economic co-operation. If Article VII of the Mutual Trade Agreement were to be implemented

in a realistic manner by means of a multilateral agreement to eliminate trade restrictions and to reduce tariffs and other trade barriers, so that economic co-operation is transferred from the realm of pious platitudes to that of specific action, India will not hesitate to fall in line with other nations, *provided* her right to 'Developmental Protection' is conceded as a legitimate derogation from the principle of free trade. The proviso just mentioned might appear superfluous to many who take a truly liberal view of the future of backward economies. But the lion in the path of world economic development is misguided liberalism which repeats the shibboleth of orthodox free trade. The authors of the British *Liberal Plan for Peace,* for example, suggest that the Economic Branch of the World Security Organization which would direct the flow of international investment should turn a deaf ear to a government that pleads on behalf of a project that it would make the nation more self-contained and less dependent on imports; it must be guided by economic considerations alone—namely, 'whether the project meets a world requirement or entails more efficient production'.[15] If developmental protection is viewed as a means to planned development of welfare in a backward country it should be possible to convince the Economic Branch that such protection would not make the nation 'less dependent on imports' and 'more self-contained'; in fact as her economy is activated and the national income rises there will be an increase in the volume of both exports and imports, although their composition will change, and the ratio of imports to home production will be kept at a high level. But if the test proposed is applied to each individual project the Economic Branch will find that the effect of protection is to make the nation less dependent on imports of *any particular class* of goods. To condemn this process as a move in the direction of autarchy and to refuse a foreign loan on that score is hardly rational. Moreover, developmental protection cannot be judged merely by the economic criteria suggested, viz., that a particular project for which a foreign loan is wanted should meet a world

15. *The Liberal Plan Peace* (*Gollancz*) p. 51.

requirement or entail more efficient production. The Liberals consistently with their *laissez faire* doctrine are opposed to the Economic Branch using its 'power as a channel of lending to dictate the lines on which industrial expansion in each country should proceed'.[16] But they want interference in 'cases where backward nations require technological assistance in development projects'.[17] Such interference is to be in the form of vetoing 'projects that would create redundant capacity'. It is obvious that developmental protection would create industrial capacity in an economically undeveloped country which may easily be interpreted as 'redundant' in a narrow sense (since imports are replaced by home production) from the point of view of the existing set-up of comparative advantage. Orthodox liberals clearly want to perpetuate sharp inequalities of economic development and the disparity in the standards of living in backward and industrially developed countries by maintaining the traditional character of international division of labour. India must make it unequivocally clear that she cannot be a party to any multilateral trade agreement which is based on such outmoded theories and is likely to interfere with her tariff autonomy and the projected course of her economic development.

While India would naturally be sceptical of an outworn liberal philosophy which describes the ambition of economically undeveloped countries to 'follow in the footsteps of prosperous nations' and to 'seek to establish the most recent line of manufacture', as 'the tyranny of fashion',[18] her best economic interests seem to lie in non-discriminatory, multilateral trade. Her position as a creditor nation that has to collect interest and amortization through an indirect route of transfer as far as possible, so that she can get the right type of essential imports (largely capital goods) in the best possible market, requires that she must work for the restoration of a multilateral trading system. Even otherwise for reasons elaborately explained in Chapter 1, India requires a

16. ibid., p. 51.
17. ibid., p. 54.
18. ibid, p., 50.

broad market for her staple exports during the period of post-war economic development. The wider the range of trade by virtue of its multilateral character, the greater the gain and the greater the stability of her export trade in terms of both volume and prices. On the other hand, constriction of India's foreign trade into bilateral or narrow triangular channels will prevent her from reaping these obvious economic advantages. The Reconstruction Committee of the Viceroy's Executive Council very wisely laid down the basic principle of the planning of foreign trade in the following words:—India must avoid 'undue dependence on a particular market for the disposal of a particular class or classes of goods and undue dependence on particular import markets'.[19] In the past the financial and political ties which bound Great Britain with India as well as British trade connexions and mercantile marine activated the economies of the two countries (although in unequal degrees) and established a basis of mutually advantageous trade. But India's 'undue dependence' upon the British market for the disposal of her exports and the purchase of imported goods has served to transmit undesirable economic fluctuations in Great Britain to the Indian economy through the medium of a fixed rupee-sterling exchange. Moreover, as the analysis contained in the last chapter abundantly shows, it was the multilateral trading system which created a wide market for primary goods in countries which were not necessarily India's best markets for imported goods, and thereby maintained the prices of primary products at a higher level than if India's foreign trade had remained largely bilateral, as it had been in the beginning, or had a much narrower basis. It was demonstrated in the last chapter how, even in the 'thirties, India's foreign trade had a wide range and had not lost its multilateral character in spite of the trade-constricting effects of imperial preference. Indian exports commanded a wide market, and India had an active balance of trade even with most of the European countries which resolutely adopted all kinds of expedients to avoid a passive balance. Indian imports were

19. *Second Report on Reconstruction Planning*, p. 23.

also derived from a wide area, and consumers had the benefit of competitive prices. India was one of the countries which suffered most during the economic depression owing to the pressure of the unilateral transfer of funds upon her export trade, the predominantly agricultural character of her exports and the failure of the Government of India to devaluate the rupee. But her economic privation would have been much more intense, if her foreign trade had a less multilateral character. After the war Indian exports will not cease to have a predominantly agricultural character, although the composition of Indian export trade must change through increasing exports of semi-processed raw materials and manufactured products. But the pressure of the unilateral transfer of funds upon her export trade will cease to exercise a deflationary pressure upon real income, and Indian currency and exchange may, with proper planning, be so adapted to the needs of costs-prices equilibrium and equilibrium in the balance of payments that undesirable deflationary tendencies may be counteracted. In these favourable circumstances the stability of the export trade in terms of both volume and prices and the maintenance of favourable terms of trade will depend upon India's foreign trade having as far as possible a multilateral character.

It is possible to imagine such multilateral ramifications of India's foreign trade as may solve some of her intractable problems of trade and economic planning. In the last chapter particular stress was laid on the tendency for Indian manufactured goods to seek an export outlet in the British colonies in Asia and Africa bordering on the Indian Ocean. In the 'thirties the trade drive of highly industrialized countries, particularly Japan, which followed unorthodox methods of trade and sales organization, undermined the position of Indian exporters. But India's geographical position and her capacity to produce 'low-income' goods, adapted to the habits of consumption of the Asiatic population, may easily put her in a position to command a wide market for manufactured products in these countries and in South-East Asia as a whole. Exports of staple manufactures (for example, textiles) must not be permitted on a large scale in the interests of domestic consumers. But they may easily

be a means of buying capital goods through multilateral trade. Countries of South-East Asia are bound to have, as in the past, an active balance of trade with advanced industrial countries, particularly the U.S.A. India may not buy tropical agricultural produce and tin, rubber, petroleum, or metals, in large quantities, but since she may export to the tropics manufactured goods in large quantities, she may have a fairly large active balance of trade with the tropical countries of Asia. This active balance may finance our net import from the U.S.A. through an indirect transfer route and thus enable us to buy capital goods from the U.S.A. which we could not buy through the process of direct and bilateral adjustment of our trade with her. Similarly India's export surplus in relation to some of the advanced primary countries which may also have an export surplus in relation to the U.S.A., Great Britain, Switzerland, Sweden, etc., which in their turn can supply India with the proper kinds of capital goods at favourable prices, may also pay for India's net import from the second group of countries, arising out of heavy importation of capital goods. India's dollar balances or sterling balances can be liquidated in the form of free currency only when multilateral trade of such a pattern as just described as an illustration can come into existence.

It has already been explained that a world-wide multilateral trading system cannot come into existence in the transitional period after the war. India may be faced during this period with organized trade blocks in the process of formation, each providing limited multilateral trading opportunities within the block, but subjecting the trade with the rival block to such discriminatory treatment as may be ostensibly necessary due to the shortage of sterling or dollar exchange as the case may be. India will have to determine a trade policy which will be adapted to the 'conjuncture' of economic tactics appropriate to a difficult period of transition from war to peace. In a sense the transitional period after the war will be a prolongation of the period of economic abnormality. Hence the technique of State trading, which developed under the inspiration of Dr. Schacht before the war and which has been found eminently practicable in war-time, viz., reciprocal bulk-purchase agreements between

countries, may not outlive its utility. This technique was used by Dr. Schacht as a most blatant form of trade discrimination which was based on one-sided pressure and was aimed at the pre-emption of supplies: it was an instrument of economic warfare. After the war it may not be used as a weapon of economic warfare, for, the international market being a sellers' market, commercial rivalry need not take such an acute form. But (as in wartime) in the absence of normal channels of trade and owing to the persisting distortion of the price-systems in different countries and the continued disharmony between the national price levels, it will be necessary to conduct trade by the unorthodox method of reciprocal bulk-purchase agreements. Hence there is a case for India entering into reciprocal bulk-purchase agreements. If a foreign country offers a large, stable and reliable market for the bulk of specific Indian exports at least for a short period of time, India may be induced to reciprocate by agreeing to buy the bulk of her requirements for such goods as she needs and the foreign country can supply within the stated period. But such agreements must be essentially non-discriminatory. How this is possible must be explained, because, at first sight, it seems to be a self-contradictory proposition. Under a payments agreement there is a general bilateral clearing of mutual payments without specific deals in respect of reciprocal bulk purchase of specific commodities. Under a reciprocal bulk purchase agreement which is reinforced by a payments agreement there is not only a bilateral adjustment of trade balance, but also a more specific assurance of sheltered markets for particular commodities rather than a general assurance in respect of the whole of the trade between two countries. It is obvious that bilateral deals as regards reciprocal bulk purchase are discriminatory in the sense that prospective buyers and sellers in other countries are deprived of free trading opportunities in the markets of the countries concluding bulk purchase agreements. But such agreements can be non-discriminatory if the offer to buy from, or to sell to, foreign countries is an open one. If the entire supply is not bought from, or sold to, a particular country, but is allocated to more than one country, the bulk purchase agreements assume the character of guaranteed import or export quotas

which are non-discriminatory in so far as the quotas go to the highest bidders and the market process is allowed to create such *unrestricted* trading opportunities as may reasonably exist. But one limitation of reciprocal bulk purchase agreements is that there will not be many countries who would be in a position to buy and sell in bulk on a reciprocal basis and yet fulfil the fundamental condition of mutually advantageous trade, viz., a 'double coincidence of wants'. The requirement that the wants of one party should match the surplus supplies of the other and *vice versa* for a mutually profitable trade bargain to be made, obviously restricts for both parties the range of choice of advantageous trading opportunities. If, however, a major trading nation like the United Kingdom purchases in bulk from India not for her consumption but for re-export, the former will be able to use her bargaining power effectively not only to get favourable terms of trade, but also to regain her former valuable and extensive entrepôt trade which was a source of her economic strength in the past. Reciprocal bulk purchase agreements may not turn out to be Dr. Schacht's agreements with Balkan countries which resulted in some of them getting unwanted type-writers and mouth organs in exchange for their agricultural products. But great precaution would be necessary to ensure that India gets the type of goods, particularly up-to-date capital goods, that she requires. Reciprocal bulk-purchase agreements are also conducive to economy of foreign exchange reserves when they are being depleted fast and an acute scarcity of foreign exchange is threatened. In so far as India's foreign balances (sterling and dollars) remain virtually frozen and scarcity of cash is a hindrance to importation of capital goods, reciprocal bulk-purchase agreements are a way out of the difficulty. But as a country which is not likely to experience the same balance of payments problem as debtor countries after the war, if she carefully husbands her resources, her problem is not so much a problem of economizing foreign exchange reserves, as one of liquidation of her dollar and sterling balances. It may be argued that bulk-purchase agreements may facilitate the liquidation of our sterling balances in a manner which may suit both the creditor and the debtor. But the extent to which liquidation of sterling balances may be induced by bulk-

purchase agreements on a bilateral basis should not be exaggerated. Great Britain would require to expand her export trade by 50 to 60 per cent to meet her requirements of imports, and her capacity to repay her sterling debt to India through export of commodities would be very limited indeed. In these circumstances while non-discriminatory, reciprocal, bulk-purchase agreements may be recognized as a makeshift, transitory arrangement to set the wheels of international trade in motion, yet almost simultaneously Indian trade policy must be directed to building up a basis of trade which will be wider than mere unco-ordinated bilateral exchanges conducted with many countries. But this means that India will have to determine her attitude to moving within the sphere of influence of a trade block which offers multilateral trading opportunities, pending the development of a world-wide multilateral trading system.

Indian industrialists and traders of late have been showing great interest in the prospects of Indo-American trade. America's vast economic potential which has borne incredible strain during the war has, rightly or wrongly, created the impression that the U.S.A. can 'deliver the goods' to all countries who wish to borrow or buy American capital goods for economic reconstruction or development. As a great creditor nation which is in a position to use the expansion of her export trade as a lever with which to raise the living standards in undeveloped countries she has inspired hope and confidence in a war-torn world. But in India at any rate our enthusiasm for the prospects of American aid should be tempered by cold realism. The present writer does not share the pessimism of those who think that in the post-war years the U.S.A. will suffer from a very sharp rise in costs of production unaccompanied by any fall in the exchange value of the dollar, or that the U.S.A. will sooner or later withdraw into the shell of economic or political isolationism, although he realizes that such fears are not entirely unfounded. Nevertheless judged by present trends and even in favourable circumstances the process of obtaining capital goods and other essential imports from the U.S.A. will not be an easy one. There is no doubt that India can import from the United States machinery, plant, equipment of all types, agricultural implements, transportation

equipment, etc. But the immense demand for American products in the countries devastated by the war might delay delivery to India by several years. The United States will not favour reciprocal bulk purchase agreements, because, on principle, she has always been opposed to bilateral clearing and bilateral adjustment of trade as a discriminatory trade practice which is inconsistent with freedom of trade and is based on State trading which offends against the principle of private enterprise. Hence not only will India have to compete freely with other countries for American products, but she may also be handicapped by the largely frozen character of her foreign exchange reserves. American loans may enable India to finance her purchases of American capital goods. But the financial experts of the United States Government are of the opinion that the chances of such loans being unconditionally offered through the United States Government or private channels appear remote. It was also recently learned that several Indian industrialists with offices in the United States sought loans from banks 'with not too encouraging results'. Indeed it has been too evident in America that India's immediate desire for American loans to finance her programme of industrialization arises from the uncertainty of the amount of dollars which may be released from the British Empire Dollar Pool for India's purchases of American goods and the virtual certainty of the sterling balances remaining very largely frozen. And it is naturally felt that India's dollar credits (and her sterling credits) must be used up before she can ask for a foreign loan. Apart from this, the terms and conditions of American loans have still to be determined to the satisfaction of both the creditor and the debtor. India will not allow foreign capital to create vested interests. For example, export of capital through the formation of 'subsidiaries' in India which will control the import and internal allocation of particular patents and processes and particular types of capital goods will not be permitted if, as is likely, it interferes with import controls and the programme of economic development. Similarly if Americans claim concessions in regard to the importation and internal distribution of certain consumers' goods as a condition of loans being granted for the importation of capital goods, they are not

increasing the trade between countries which conclude such agreements, without reducing the trade with countries outside the block, is not restrictive of world trade. In fact there is a theoretical case for preferential unions if (1) the States which formed them reduced the rates of duty *inter se* and did not raise the rates against other countries, and (2) if any other country which pursued a policy of low tariffs was free to enter the union by making concessions to the members of the union comparable to those which the latter had made to each other. It is very probable that this was the general theoretical basis of the Hull Trade Agreements programme which was designed to lower tariffs all round and to open up the channels of freer trade. But the Ottawa preferences were very differently conceived. They did not lower barriers to trade within the British Commonwealth and the Empire without raising barriers to trade with countries outside the trading block. They were frankly restrictive of world trade and created international ill-will. While they yielded a joint advantage to members subscribing to the Ottawa preferences at the expense of outside parties, it is doubtful, so far as India was concerned, whether there was a net gain to her. If the scheme of empire preferences is revived now it is bound to be opposed by the Dominions and India.[21] In the 'thirties, while New Zealand received 73·3 per cent and Australia 60·3 per cent of her total imports from the Empire countries, South Africa obtained 57·6 per cent, Canada 29·9 per cent and India 49·4 per cent of total imports from the same source. The export trade of Canada, South Africa and India was also wide-spread in spite of the trade-constricting effects of the Ottawa preferences. Since Canada, South Africa and India have repaid their debts to Great Britain, in the absence of multilateral clearing it will no longer be necessary (as it was

21. Commenting on the attitude of the Dominions, the author of *Trade Relations Between Free Market and Controlled Economies* (League of Nations, 1943) says: 'the Dominions were not wholly satisfied by the preferential treatment they were given under the Ottawa Agreements and looked with an especially jealous eye at any concessions which Great Britain granted to non-British exporters of agricultural products' through her system of import quotas (p. 65). What was true of the Dominions was also true of India.

in the 'thirties) for these countries to develop an export surplus in relation to Great Britain. They will be reluctant to go back to the system of Ottawa preferences and will naturally seek a structure of multilateral trade which will cut across the boundaries of the Commonwealth and the Empire and will ensure better and more stable prices for their exports. If we exclude Great Britain, they have no important stake in intra-Commonwealth or intra-Empire trade. At any rate so far as India is concerned, judging by the trend of trade in the inter-war period, we come to the conclusion that the only Dominion which had considerable trade with India was Canada. Moreover, we must not forget that if the British Commonwealth and the Empire constitute a preferential trade block on the basis of the Ottawa preferences, there will be sufficient provocation to form a pan-American preferential trade block which will at once injure the economic interests of both Great Britain and the Dominions, particularly Canada and South Africa. The revival of colonial preferences and quotas will be equally undesirable. While they will tend to prevent the poverty-stricken colonial peoples from buying in the cheapest market, they will also offend against the principle of 'equality of access to raw materials' which is an economic basis of durable peace.

Suppose, as is likely, the Sterling Area rather than the British Commonwealth and the Empire is organized into a trade block, and includes not only the British Commonwealth and the Empire but also, as the *Economist* has suggested, Holland, Belgium, Denmark, Norway, France and Portugal with their overseas dependencies. Suppose the members agree to avoid trade disequilibria and large-scale depressions, seek multilateral settlement of accounts within the trade block, minimize trade restrictions within the block, try to secure 'upward balancing' of trade, welcome any nation that agrees to these conditions, and subject the trade with countries outside the block to such restrictions as are necessary in view of scarcity of dollars. Should India be a member of such a trade block *if a wider basis of trade does not exist?* There cannot be any *a priori* objection to India entering such a trade block provided certain essential conditions are fulfilled. In the first place, the Sterling Area must

be what may be called a full employment block. The members must recognize that every nation, great or small, economically developed or undeveloped, must pursue a policy of full employment. Developmental protection as a means to the planned development of welfare must be accepted as a principle of fiscal policy. Moreover, there must be co-ordination of the recovery and development programmes in different countries who become members of the trade block. Otherwise a sharply unequal pace of economic development will result in trade between highly industrialized and less developed economies degenerating into an instrument of economic exploitation through the alteration of the terms of trade to the disadvantage of undeveloped countries and the consequent increase in the disparity between the standard of living in the advanced industrial countries and that in the predominantly agricultural countries. In the second place, India must be convinced that through bulk purchase agreements (which need not be reciprocal in so far as bulk sale in one country may finance bulk purchase in another through the process of triangular or multilateral trade) or otherwise she would be able to buy capital goods and other essential imports on reasonably fair terms and to sell her exports in the best possible market. In the third place, there must be a substantial liquidation of India's sterling balances on a multilateral basis within the Sterling Area. And lastly, India's terms of trade should improve in comparison with what they were before the war. This condition is the most important safeguard on which India must insist with all the emphasis at her command. The *Economist*, commenting on the improvement of Great Britain's terms of trade before the war, said that 'in 1938 it was possible to pay for a unit volume of imports with 30 per cent less of exports than in 1913. This improvement, on the balance, created much more employment than it destroyed, and it certainly raised the standard of living'. Quite the reverse of this statement was true of poor countries like India who are producers of primary products. The widening of the disparity in the standards of living caused by an adverse change in the terms of trade is a tendency which must be resisted by primary countries. But, as the *Economist* said, 'the policy of keeping

import prices low is part of the trade policy' of Great Britain.[22] If import prices are high, either real wages will be low with consequent damage to Great Britain's standard of living, or export prices will be high with consequent damage to Great Britain's export trade. Here there is an obvious conflict between the economic interests of primary countries in the position of India and those of an industrial country like Great Britain. The authors of the *Liberal Plan for Peace* in spite of their economic orthodoxy are essentially realists when they say that after the war 'attempts will be made, in some cases with justice, to secure a more favourable relation of the prices of primary to those of manufactured products', and that as the result of this and other causes which will exert a pressure upon Great Britain's economy to maintain the volume of exports at a high level, 'she will have to export a greater quantity of goods in order to purchase the same quantity of imports; and she will have to offer them at low enough prices to attract purchasers'. Great Britain will have to accept this position, and the *Economist* should not expect India to become a member of a trade block with Great Britain as the centre if the position is likely to be different from what the British Liberals have clearly foreseen.

22. *The Economist*, 12 February, 1944.

CHAPTER 4

RECONSTRUCTION OF FOREIGN TRADE—GENERAL PRINCIPLES AND OBJECTIVES

With the close of the war India is faced with a new orientation of the problem of her foreign trade. Both the structure and dynamics of her foreign trade will undergo a radical change, not only because her foreign trade may be subordinated to the requirements of internal economic development, but also because even otherwise the altered circumstances of the post-war period will put a different complexion upon the problem that was discussed in chapter 1. We have seen that the position of the Indian export trade was being undermined before the present war by (1) the radical change in the relation between the prices of primary goods and the prices of secondary goods to the disadvantage of primary producers, and (2) the pressure of the unilateral transfer of funds upon the export trade which made the terms on which India imported secondary goods still more unfavourable. The short-lived boom which preceded the trade recession of 1937 was a silver lining in the cloud for the rest of the world, but in India the economic gloom was as intense as before. Economic thought was turning to national economic planning, to the need for insulating our internal economy against international economic disturbances and to creating a purely domestic market for our export goods. Since there was no means of translating these ideas into practice, the economic situation in the country was considered to be desperate in spite of the apparent boom in a few protected industries. The war has changed the entire atmosphere. The inflationary war boom has generated expansionist ideas, stimulated economic enterprise, and revealed unsuspected potentialities of industrial skill and ingenuity possessed by Indians. Although war-time economic controls have not been entirely successful, yet the measure of success as well as of failure of such efforts has strengthened the belief that planned direction of a nation's economic life is desirable in the interests of the community. All the world over there is an

irrepressible aspiration for a higher level of efficiency and welfare for the common man. The average Indian has also been stirred by this universal feeling. Above all there is the hope that the new world economic order would create conditions under which the planning of full employment and a high standard of living in advanced industrial nations will assist, or at least will not hamper, similar planning in economically under-developed countries. We have to bear in mind this new climate of opinion when we try to look ahead and visualize the prospects of India's foreign trade after the war. But will the background of her foreign trade be different from what it was before 1939? Will the structure and dynamics of her foreign trade revert to the *status quo ante?*

One of the major factors which will govern India's balance of payments and the dynamics of her foreign trade after the war is the reversal of the debtor-creditor relation which has subsisted between India and Great Britain for about three-quarters of a century. Repatriation by India of virtually the entire amount of her external public debt (the whole of which was in sterling) within the space of a few years after the commencement of the war is a remarkable event in the financial history of this country. A combination of favourable circumstances in which economic opportunism from the point of view of India's economic interest was reconciled with the interests of Great Britain and other allied nations was responsible for this remarkable financial achievement. Repatriation of sterling loans had been decided upon by the Government of India as a definite financial policy in 1937-38. Probably it had been realized that the existence of a large mass of fixed foreign obligations operated as a drag upon the rate of exchange under the prevailing conditions of trade depression and upset the remittance programme of the Government of India. Perhaps by then it had also been felt that the pressure of the unilateral transfer of funds upon our export trade had to be progressively released if the Indian economy was to survive the shock of the long-continued trade depression. In spite of the fact that the merchandise balance of trade was not quite favourable and the rupee-sterling exchange not quite firm, the Government of India purchased in the open market in London sterling loans of the value of

£·84 millions (against the creation of rupee counterparts to the extent of Rs. 1·12 crores) in 1937-38, and liquidated completely their liabilities in connexion with the family pension funds amounting to £9½ millions, in 1938-39. The outbreak of the recent war presented a golden opportunity. After the commencement of hostilities there was a rapid shrinkage in the volume of our import trade due to the pre-occupation of the exporting countries with war effort, restrictions on shipping space and increasing incidence of freight and war risk insurance, and the cutting off of large supplies of imported goods from some of the enemy countries. The machinery of import control and priority for essential imports was designed to reduce the volume of imports to the minimum. At the same time India became an important base for the supply of essential war materials, foodstuffs and other consumers' goods manufactured in India to His Majesty's Government, for which India was paid in sterling in London.[1] Thus a colossal amount of sterling began to accumulate in London to the credit of the Reserve Bank of India. The Government of India was responsible for making rupee finance immediately available in India. Since sterling could not be sold to a corresponding extent in the open market in exchange for rupees as in normal times, necessity was felt for utilizing sterling for the repatriation of Indian sterling loans in the London market. The Government of India accordingly authorized the Reserve Bank of India to purchase on their behalf non-terminable Indian sterling loans on favourable terms and to transfer the scrips to themselves for cancellation against the issue of additional rupee paper of 3 and 3½ per cent non-terminable loans. The additional rupee paper was to be held by the Bank till it could be re-issued to the public according to the requirements and conditions of the market for the Government of India securities. This scheme was followed by a further scheme of voluntary repatriation under which the holder of a terminable sterling loan was given the

1. The whole of the war supplies was not obviously exported, but the effect upon the accumulation of sterling was the same as if it had been exported.

option of transferring his holding to the Rupee Register of the Reserve Bank, but the rupee counterparts, once issued, could not be reconverted into sterling, although the yield and the maturity of the rupee counterparts were to be the same as those of the sterling holdings. This scheme perhaps did not quite appeal to the holders of Indian sterling loans. History was created, however, when on 8 February 1941 the Government of India announced that they had taken action, with the concurrence of His Majesty's Government, to compulsorily acquire the whole of the terminable Indian sterling loans which were still outstanding. The ultimate outcome of these financial operations has been spectacular. The Finance Member announced in his budget speech of 1944 that the sterling holdings of the Reserve Bank of India on 31 March 1944 were approximately Rs. 950 crores. So far as concurrent utilization is concerned, the 'possibilities of repatriation of our public debt have very nearly been exhausted.' The Government of India repaid virtually the whole of the pre-war sterling debt of £360 millions, and the sterling debt outstanding at the end of the financial year consisted of the comparatively small amount of £11½ millions of Government of India Stock and railway debentures which represented holdings which either fell outside the scope of Vesting Orders, or in regard to which there was delay in surrendering the scrip for redemption. Not only was the entire sterling debt almost repaid, but the net sterling assets also increased since the outbreak of the war from £52 million to £737 million in 1944 leaving only perhaps £200 to £250 million of private British investment in India. The debtor-creditor relation between Britain and India thus shifted by £1045 millions. In the opinion of the *Economist* 'India during the war has invested in Britain and repaid sterling debt to about twice the amount of British capital which went to India over the preceding three-quarters of a century.' And Great Britain's debt to India which was already about £750 million in 1944, was growing at the rate of £300 million a year. The *Manchester Guardian* summed up the situation by saying that at the end of the war 'Britain will have a debt to India as large as the debt to the U.S.A. after the last war.' We must not forget, however, that these spectacular consequences

of the war on Indian public finance have had far-reaching repercussions on the economy of a poor country which has been called upon to bear the unprecedented strain of an accelerated war effort for which she was hardly prepared. It is the accumulation of sterling balances in the Issue Department of the Reserve Bank which has served as the backing for the phenomenal increase of paper currency *pari passu* with the increasing need for rupee finance in respect of the purchases of the Allied nations and expenditure on war operations in India. Repatriation and accumulation of sterling debt are thus closely connected with the mechanics of inflation which has provided a mechanical stimulus to the acceleration of war effort and has been a crude instrument through which the hectic tempo of a backward, low-level economy could be geared to meeting the needs of war.[2]

We shall discuss later how far the sterling balances are likely to figure as a major factor in determining the equilibrium of India's balance of payments. In the present context the significant fact which emerges from the story of repatriation of sterling loans is that the pressure of unilateral transfer of funds on our export trade, which had been causing anxiety as a dislocating factor in the economic situation during the inter-war period, has entirely disappeared. This will be conducive to better economic re-adjustment parti-

2. Readers are perhaps aware of the process by which this has happened. In a country with a low economic potential which was hardly prepared for an unprecedented expansion of the scale of production for war, it is money which has been used as an instrument to achieve the end. War production had to be made suddenly more profitable, so that resources could be mobilized as much as possible for war production, subject to the bottlenecks created by restriction on the import of machinery and other adjuncts of production. Personnel and organization had to be crudely created by means of wasteful, stop-gap arrangements. If other methods had been adopted for the mobilization and husbanding of economic resources, things would have taken a better turn. If, for example, the industrial potential of the country had been raised by building up her productive power according to a systematic plan, India could have built up a high-level, expanding economy in spite of, and perhaps because of, a moderate degree of monetary inflation.

cularly in periods of economic stress. But a major problem of India's foreign trade has been the deterioration in the terms of trade caused by the radical change in the prices of primary products in relation to the prices of secondary products which occurred during the inter-war period. As Mr. H. D. Henderson says:

'The growing excess of productive capacity for most tropical products constitutes a serious menace to their prosperity and confronts them with formidable problems of readjustment. There is a sense in which it is true that colonial peoples are, even today, "exploited." The exploiting agencies are the tendencies working through the blind forces of supply and demand to reduce the prices of tropical products to unremunerative levels. The beneficiaries of this exploitation are the consuming publics of the industrial nations.'[3]

He emphasizes the seriousness of the economic situation in economically backward countries of the tropics by referring to the divergent rates of population growth in industrial and agricultural countries and the technical progress of agriculture. India has already realized the nature of her economic problem, and is determined to face the 'formidable problems of readjustment,' which for her are nothing but problems of planned economic development. For India, to quote Mr. G. D. H. Cole, 'full employment is a matter of extending capital resources and improving productive technique.'[4] But with the best of goodwill and effort and opportunity achievement of 'full employment' will take at least a generation after the war. How are we to plan our export trade (as well as our import trade) during the period of transition?

There is a section of economic opinion in this country which is dominated by the restrictionist mentality of the period of economic depression. According to this school of thought, the reconstruction of our export trade must be based on curtailment of exports. Why? Since the foreign market is an extension of the home market, the chronic defects of

3. H. D. Henderson, *Colonies and Raw Materials*, p. 29.
4. G. D. H. Cole, *The Means to Full Employment* (1943), p. 149.

the system of agricultural production which are reflected in the home market are equally reflected in the foreign market, so that our export staples are not *really exportable* from the economic point of view. It is true that the unremunerative character of primary production is a chronic evil and is inherent in the nature of our agricultural economy. But if our agriculture is not a business proposition, it is unremunerative in the domestic market as well, and not merely in relation to our export market. By a parity of reasoning, curtailment of exports of agricultural products should also mean curtailment of agricultural production as a whole. But would it not be the object of national economic planning after the war to bring about not a restriction of agricultural production but its optimum expansion under the changed conditions of a balanced national economy? In fact no plan of economic development will have achieved anything if it did not raise agriculture from the level of a deficit economy and make it a business proposition not only in relation to the home market, but also in relation to the foreign market. Agriculture to be a remunerative occupation must unload the surplus man-power (men who add little to the volume of agricultural production and are victims of 'concealed' unemployment) which must be diverted to secondary and tertiary production. For the less developed countries in general and for individual countries of large size and diversified resources such as India, economic development requires a considerable degree of industrialization in the sense of growth of 'Secondary' production (processing industries, semi-manufactures, light consumers' goods industries and heavy industries). As the level of national income rises an increasing proportion of workers will be engaged in retail and wholesale trade, transportation and communication services, and administrative, medical, educational and other professional services, i.e., 'Tertiary production', in the words of Colin Clark. One writer concludes on the basis of statistical comparisons with other areas, that the low per capita income of India could be doubled if, with the more efficient use of human and natural resources, only 15 per cent of her working population were shifted from food production to other pursuits, and that additional shifts of less than 10 per cent

would treble income.[5] It is easy to see that the ultimate effects of the occupational redistribution of population which will be the cause as well as the effect of economic development will be (1) an increase of agricultural output *per unit* of fully employed factors of production, and (2) an expansion of agricultural output *as a whole* under the stimulus of an improvement in the terms of exchange between agricultural products and manufactured products and services. This will improve the position of agriculture *equally* in the home market and in the foreign market. But the reasoning employed here does not imply that our export trade should be left to the free working of the 'blind forces of supply and demand'. It would be clearly necessary to plan our export trade.

Sometimes the argument in favour of restricting the export of agricultural products is stated in a more subtle form. It is argued that since India aims at a balanced economy, the development of agriculture should be limited by the potentialities of economic development within the country. The authors of the Bombay Plan of economic development of India envisage a 130 per cent increase in the net income from agriculture, as compared to a 500 per cent increase in the net income from industry. Although a 130 per cent increase in the net income from agriculture, provided this increase is generally diffused amongst the agricultural masses, would certainly be a great achievement under the existing conditions, yet the disparity in the rates of growth of industry and agriculture is supported by a process of reasoning which is of particular interest in the present context. They say that 'it is not likely that more than 130 per cent increase (in agricultural output) will be *absorbed within the country*'.[6] In another context they express the opinion that 'in respect of agricultural commodities India should as far as possible aim at feeding her own population adequately and should not aspire in the initial years of planning to export to

5. Louis H. Bean, *Industrialization, the Universal Need for Occupational Adjustment out of Agriculture,* cited in *World Economic Development* by Eugene Staley, p. 5, footnote.

6. *A Plan of Economic Development for India,* p. 24.

foreign markets'.[7] It is obvious that production of the minimum amount of staple foodgrains and other kinds of protective food required in a balanced diet will have priority in any scheme of crop planning. But the domestic industries will require raw materials. In estimating a 130 per cent increase in the net income from agriculture, the authors of the Bombay Plan, therefore, take into account not only an increased demand for food due to an increase of population and a higher level of income which the nation is expected to attain, but also 'the larger demand for industrial raw materials'. On the whole the essence of their recommendation is that in the initial years of planning our agricultural economy should be self-sufficient, and should as far as possible be cut off from the export market, and that even later the pace of agricultural development should be determined by the size of the agricultural output which can be absorbed within the country.

So far as one can foresee the future, isolating our agricultural economy from the world market in the initial years of planning after the termination of the war and even at a later stage, is neither practicable nor expedient. After the war India will require a stable basis of export trade to obtain at least her requirements of capital goods. According to the Bombay Plan, the country will have to depend upon her export trade for financing her imports of capital goods to the extent of an average of Rs. 40 crores a year.[8] It will not be possible for India to maintain a fairly large volume of imports of capital goods (assuming that imports of consumers' goods are reduced to an insignificant amount) with exports reaching almost a vanishing point, in the initial years of planning. Nor is it likely that agricultural production could be immediately reorganized on the basis of national economic self-sufficiency without serious dislocation and without throwing a disproportionate burden on agricultural incomes. While, therefore, it would be clearly unwise to think of our export trade in terms of autarchy, it is none the less necessary to

7. ibid., p. 30.

8. The summary of the sources of finance includes 'Balance of Trade' contributing Rs. 600 crores during the planning period. c.f. *The Plan of Economic Development for India*, p. 48.

plan it with an eye to the changing needs of our internal economy. The Policy Committee on Agriculture, Forestry and Fisheries (appointed by the Government of India to deal with post-war reconstruction) came to the conclusion that 'the production of raw materials should be increased to meet the growing needs of industry as well as the *requirements of export,* while maintaining a balance between food and cash crops'. This is certainly a rational plan which can succeed only on the basis of a centralized control of crop planning and agricultural production and regulation of both internal and external trade in agricultural products. It does not run counter to the basic ideas of the Bombay Plan, provided it is assumed that priority will be maintained in the scheme of crop planning for adequate production of food and raw materials for the internal market. But it is based on the unambiguous recognition of the principle that a balanced economy need not necessarily be a self-sufficient economy, and that agricultural development need not be limited by what can be 'absorbed within the country'. As far as one can see, economic development in India will follow the lines of advanced primary countries, and there will be ample scope in favourable circumstances for mutually advantageous trade with the rest of the world. With regard to crop planning the authors of the Bombay Plan rightly admit that the 'areas under commercial crops like jute, tea, cotton, oilseeds, etc., the fortunes of which are to a substantial extent dependent on foreign trade and which have introduced a serious element of uncertainty in our economic life, would have to be *adjusted to the conditions of international trade which might prevail in the post-war period*'.[9] But what are the implications of this statement? The task of crop planning in the case of commercial crops will be two-fold:—(1) securing for what the planning authority decides to produce a stable market within the country as well as abroad, and (2) adjusting production not only to conditions of international trade, but also to *conditions of domestic demand* in such a way that prices fetched by them do not fall to unremunerative levels. It is

9. ibid., p. 30.

not necessarily unreasonable to anticipate that a *secure* external market as well as *remunerative prices* for a portion of the total outturn of commercial crops may be assured to India after the war. In his book *The Means to Full Employment,* Mr. G. D. H. Cole discusses the probability of a rise in the prices of foodstuffs and other primary products in terms of manufactured goods, and says that 'such a change in the terms of trade is likely, if the countries producing primary products have a say in determining the conditions of post-war international exchange'.[10] Moreover, the international market after the war, as Keynes has put it, will be a 'sellers' market' with a colossal demand for primary products occasioned by economic rehabilitation and reconstruction, impinging upon a comparatively short supply. Colin Clark has argued in *The Economics of 1960* that in the future the terms of trade will move against industrial products and in favour of foodstuffs and raw materials. This view is based on the assumption that resources will move into industry at a faster rate than that at which they are driven out of primary production by low prices. Whether this will happen will depend upon the extent of the wastefulness of the war. But there is no doubt that in the period immediately following the war Colin Clark's prediction will come true. There is no reason why India should not take advantage of the favourable terms of international trade in raw materials if and when they materialize. It may be possible for her to export processed and semi-processed agricultural raw materials, or industrial raw materials and essential minerals, or even manufactured consumers' goods (to economically undeveloped neighbouring countries) on favourable terms of exchange to obtain food, or capital goods or intermediate products whenever it would be expedient to do so. There is no doubt that the Indian heavy industry would play an important part in the early stages of rehabilitation and reconstruction in South-East Asia and perhaps parts of South China. This would be an important single factor which will stimulate India's export trade and enable her to obtain food and other tropical products which she would

10. Cole, *The Means to Full Employment,* p. 138.

badly need after the war. India would require what Marshall described as 'resourcefulness of supply' in relation to her export trade. But it cannot be too often stressed that the exigencies of internal economic development will be the overriding consideration in determining the pattern of her export trade.

With the close of the war a number of factors are likely to exert pressure upon India's export trade and make it necessary for her to maintain it at a high level. There is, first, a clear possibility of an orgy of spending. A vast amount of purchasing power which has remained immobilized due to war-time scarcity of consumers' goods and war-time controls, may impinge upon a freer circulation and supply of such goods—a situation, if left uncontrolled, might easily lead to serious inflationary consequences. Such a situation can be forestalled and controlled only by an increase in the output of consumers' goods within the country according to plan and/or control of civilian consumption. But otherwise if a large consuming capacity impinges mostly upon imported consumers' goods in an orgy of spending, there may not only be dangerous inflationary consequences, but it may also become impossible for India to buy her requirements of essential capital goods abroad for post-war economic development at reasonable prices. Since India has been starved of precious metals, a hectic absorption of precious metals after the war will have similar consequences. Again, if the rupee, which is overvalued now because it is not a free currency, faces a free foreign exchange market after the war and finds its own natural level after the hectic inflation of the war period through a process of depreciation in terms of sterling as well as the dollar, there may be an expansionary effect upon our export trade, but the rupee prices of imported capital goods may become abnormally high. Hence it is quite clear that in the period immediately following the war unless (1) the orgy of buying imported consumers' goods is rigidly controlled and imports of such goods reduced to an indispensable minimum; (2) import of gold and silver on private account is reduced to a safe minimum; and (3) exchange control is exercised in such a way as to permit imports of essential capital goods and indispensable consumers' goods at reason-

able prices, the accumulated foreign balances (to the extent to which they are liquidated as a commercial balance) may be dissipated, and/or the terms of trade may easily deteriorate to the extent of creating a major economic crisis.[11]

The Government of India decided in 1944 to meet the financial needs of post-war economic planning by building up a Reconstruction Fund which could not only finance the re-equipment of railways and the electrification and irrigation schemes of the Provinces after the war, but could also be used, as the Finance Member said in his budget speech in 1944, for purposes of national planning in general and purchase of plant and machinery for an expanded industrial system in particular. The creation of the Reconstruction Fund served an immediate counter-inflationary purpose. Its utilization for post-war economic reconstruction and development will divert a corresponding amount of purchasing power from possible expenditure on consumers' goods to the purchase of capital goods and financing of public works. But in so far as capital goods have to be imported through the normal channels of international trade, the difficulty of obtaining them at reasonable prices in terms of our exports cannot be ignored. The Finance Member also announced in 1944 that in the future a part of the dollars accruing from India's exports to the U.S.A., apart from, and in addition to, our current dollar requirements which were met from the Empire Dollar Pool under the usual Sterling Area arrangements, would be held in a dollar account with the Bank of England by the Reserve Bank of India and would be available after the war. The magnitude of India's dollar balances forming part of the Empire Dollar Pool as well as balances which have accumulated in the dollar account with the Bank of England, cannot be easily assessed. New York exporters have alleged that

11. It must be pointed out that uncontrolled speculation in capital issues is a potential danger to planned economic activity after the war. The machinery of control of capital issues, in so far as it is judiciously controlled in the interests of planned economic development, is bound to play an important part in controlling the direction and tempo of industrial development, (till it reaches the optimum point) and avoiding an undesirable inflationary boom in the capital market.

India's war-time accumulation of *large* dollar balances was being converted into sterling as part of the deliberate effort of the British to bar the Americans from the Indian market. On the other hand, British financial circles have asserted that this is a complete distortion of the actual situation. They have pointed out that the United States has been pursuing a policy of 'keeping British pockets empty of dollars'. According to them the Empire Dollar Pool was designed to mobilize every dollar earned by the Empire to pay the U.S.A. for essential imports, thus reducing Britain's Lend-Lease requirements from the United States. The United States Treasury has always restricted dollar accumulations in Britain and the Sterling Area (including India) to a minimum working balance. Hence, according to them, India has never had any substantial dollar balance of her own. The future of these dollar balances is equally obscure. These balances may pay for capital goods imported from America after the war. They may also be used for paying India's contribution towards the capital of the proposed International Bank for Reconstruction and Development, or for subscribing India's quota in respect of the International Monetary Fund, or her contribution to the funds of U.N.R.R.A. In the latter case payment through an export surplus will be avoided, so that a corresponding pressure upon her export trade will be obviated. But since India will require capital goods from the U.S.A. (unless, as some British economists say, the U.S.A. after the war will suffer from a very sharp rise in production costs unaccompanied by any fall in the dollar, so that it will be easier to buy in Britain than in the U.S.A.) to lay the foundation of an expanded industrial and agricultural structure, to the extent that India does not pay for such goods through the liquidation of dollar balances, she will have to use her export surplus, and/or raise a dollar development loan. It has been explained below why India cannot bank upon a considerable liquidation of sterling balances even on a bilateral basis, the possibility of multilateral convertibility being still more remote. In these circumstances she may have to largely fall back upon either foreign loans or free dollar balances, apart from her general export surplus, as the alternative means of obtaining capital goods. India may have to tap all sources. But it will be

clearly unwise to use dollar balances for other than the essential purpose of obtaining the means of production.

The necessity of planning our export trade after the war in the interests of the stability of agriculture and planned economic development may generally appear reasonable more or less on *a priori* grounds. But to emphasize the urgency of this problem, the inevitable necessity of economic controls (which have already been briefly outlined and will be further discussed towards the end of this chapter) and the sacrifice which they may involve for a poor country, will seem to be an unduly alarmist attitude to those who have been banking on the liquidation of India's vast sterling balances and its unfettered utilization for planned economic development after the war. Will not liquidation and concurrent utilization of these balances put India in possession of a 'vast reserve of exchange convertible into gold and spendable anywhere'? Will it not set in motion the dynamics of a unilateral transfer of funds and create a large import surplus in India's favour? Will it not, therefore, be possible for India to obtain at least her necessary imports without facing a possible deterioration in the terms of trade? It is necessary at this stage of the argument to speculate upon the future of India's sterling credits (which has already become a bone of contention between the creditor and the debtor and aroused bitter controversy) and to assess realistically how far such expectations are likely to be realized after the war.

It is well known to students of Economics that before the war, at any rate for many years, Great Britain's income from exports of manufactures together with the income from services rendered to other countries, had exceeded the amount required in respect of payment for imports. These surpluses accumulated to such an extent that before the war the interest on them paid for more than 1/5th of Great Britain's imports. In addition she performed many ancillary services for the rest of the world. As the world's carrier, she derived an income sufficient to pay for 1/9th of imports before the war. The annual income from other sources approximated in value to the total value of exports of her leading manufacturing industries. Even in 1938 the aggregate income from overseas investments,

shipping and other services paid for more than ⅓rd of all the retained imports of food and raw materials. Great Britain will emerge from this war as a country with seriously depleted overseas assets. Mr. G. D. H. Cole says: 'even if we assume that no payments will ever be demanded on account of Lend-Lease arrangements for most of the supplies sent into this country during the war, it is highly likely that Great Britain will emerge into the post-war world with only enough overseas assets to balance claims arising out of the ownership of capital invested in Great Britain, or, in other words, with a net income of nothing at all'. But it is very likely that a large part of the overseas investments owned by British residents will have been sold in paying for war supplies, while other income-yielding assets have been lost through other causes.[12] Thus Great Britain after the war will have to face the necessity of meeting a much larger proportion of her bill for imports from current exports, and of largely increasing the volume of her exports to maintain her imports of food and raw materials *at pre-war* levels. Paying for a larger amount of imports to sustain a higher level of employment, welfare and social security will be a still more formidable problem.

Britain's capacity to repay her war debt has to be viewed against this background of hard reality. Lord Keynes stated in a press conference held during the session of the International Monetary Conference in July 1944 that 'Britain's debt in blocked balances will approach 12 billion dollars by the end of 1944. Britain considers that debt her own obligation resulting from the necessity after Dunkirk of pushing the war effort regardless of cost'. India's sterling credits which were piling up at the rate of £200 to £300 million a year were likely to reach £1000 million-mark at the end of the war. Such a debt would be as large as Great Britain's debt to the U.S.A. after the last war. It would be irrational to imagine that such a large amount of debt could be liquidated by Great Britain within a short period of time by a process analogous to the payment of German reparations after the last war. Great

12. A White Paper issued on the 28 November 1944 said that British overseas assets valued at £1,065,000,000 have so far been sold, while new overseas liabilities were incurred totalling £2,300,000,000.

Britain could not be expected to create an export surplus through heavy taxation and deflation of prices and incomes, substantial enough to liquidate a colossal debt. Informed opinion in India realizes the transfer difficulties inherent in the liquidation of large debts. But it has so long been taken for granted that an orderly disposal of sterling balances would not be beyond the capacity of Great Britain. In fact the international currency plans formulated by Keynes and White respectively were calculated to strengthen such a belief. The Keynes plan contained a broad hint that the solution might be found in some special arrangement by which sterling balances could be converted into *Bancors* (the international currency unit) by India, while there would be no corresponding strain on the *Bancor* resources of Great Britain, or at any rate, the resulting strain would be spread over a period. This meant that Great Britain would be given an additional quota of *Bancors*. The immediate economic effect would be to enable India to convert these balances into goods at the expense of those countries which actually incurred these surpluses. *Ultimately*, of course, Great Britain must pay in goods. The American plan was more complicated and vague, but according to the authoritative interpretation of Clause III-9 of the White Plan given by Joan Robinson in the *Economic Journal*, 'Great Britain is required to pay off 80 per cent of the balances in free currency over 20 years. The disposal of the 20 per cent which will remain after 23 years, will be the subject of consultation between Great Britain and the Fund'.[13] At all events an orderly liquidation of sterling balances over a certain period of time was clearly envisaged by both Keynes and White as a financial transaction which was not beyond the realm of practical politics. Until recently economic opinion in Britain was not disposed to exaggerate the adverse consequences of the war on Great Britain's capacity to meet her contractual obligations. In 1942 the *Economist* had maintained that in spite of the reduction of something like £250 millions in Britain's income from 'Invisibles', 'a successful policy of full employment

13. *Journal of the Royal Economic Society*, June-September, 1943.

after the war by employing a million people who formerly were out of work, would at any rate restore the lost real income. Every index of economic growth shows a steady and predictable rate of advance '.[14] According to Colin Clark within two decades the industrialization of Japan and China could bring about a new industrial revolution in all the producing countries of the world. He calculated that output would grow in Asia, in Africa, in Latin America and in the Balkans. But economically undeveloped countries have to be developed by world investment to become buyers and consumers. Since India requires her sterling assets to be used for economic development, the liquidation of these credits should also be looked at from the point of view of full employment in Great Britain. Hence it may be argued that, given fuller employment in economically backward countries, if Great Britain continues her drive for greater technical efficiency, for raising output per head, and for developing new techniques and industries, it should be possible for her to maintain a sufficiently high level of exports not only to buy necessary imports, but also to gradually repay her debt.

Recently, however, the whole controversy has seemed to be drifting towards a strange denoúement. The British currency plan had contemplated that Great Britain could hope to liquidate sterling balances by means of *Bancor* credit, immediately available after the war, although she was expected ultimately to pay in goods. Since this implied that these balances could be converted into goods at the expense of the surpluses incurred by other nations, it was quite clear that the liquidation of these balances imposed an impossibly severe strain on the available amount of liquid international monetary resources. Since the U.S.A. may be the only country which could be expected to run a large surplus on income account after the war, the acute scarcity of dollars would make such a scheme of liquidation of sterling balances entirely chimerical. It is for these reasons that the settlement of ' abnormal war balances ' has been excluded from the scope of operation of the International Monetary Fund. It seems

14. *The Economist*, 6 June, 1942.

that both Great Britain and America are anxious to play for safety. This may be a logical position, but one should have expected the Allied Nations to agree to set up some kind of international machinery for the liquidation of sterling balances on an equitable basis rather than leave it to be settled by negotiation between a debtor whose capacity to pay in goods after the war has been seriously impaired and a creditor like India who is straining every nerve to play for minimum economic safety which the utilization of these balances will ensure.

The position that has thus crystallized so far should not encourage us to pitch our expectations too high. Rightly or wrongly India has hoped that her sterling balances would be treated as a multilaterally convertible asset to be used *whenever* and *wherever* she liked. She would have conceded that these assets could not, in view of serious transfer difficulties, be used *whenever* she liked, and that interest and amortization payments could be spread over a number of years. But it is very necessary that sterling assets should be multilaterally convertible into free currency, because otherwise India may not be free to purchase her requirements in the cheapest market and also fail to avail herself of sufficiently large liquid resources owing to Great Britain's difficult balance of payments position after the war. In 1944 when the draft scheme of an International Monetary Fund, replacing the Keynes and White currency plans, was published, it was foreseen that the liquidation of sterling balances on a multilateral basis as part of the machinery of international monetary organization was clearly impossible. But there was a forlorn hope that the supplementary scheme of an International Bank might perhaps provide for some machinery for the conversion of sterling balances into foreign exchange through the banking process, of which there was a broad hint in the Keynes Plan. Even this hope vanished when it was disclosed that the International Bank cannot permit India to borrow on an important scale foreign exchange, particularly dollars, which could be repaid over a period of time in sterling released from the blocked sterling balances. There is a provision in the scheme which would allow the Bank to take such action, but it is restricted to meeting an *emergency*. As Sir C. D. Deshmukh,

Governor of the Reserve Bank of India and a member of the Indian Delegation to the Bretton Woods Conference explained, India's case for a gold and dollar overdraft against only a *small portion* of the sterling balances which might enable India to get on with her development plans in the transitional period, in the event of Great Britain finding herself unable to supply the kind of goods that India required, was met by the British objection that such a plan meant a joint guarantee in respect of the repayment of such overdrafts over a period of years—a commitment which could not be undertaken on account of uncertainty in regard to Great Britain's balance of payments position after the war.[15] If the possibility of multilateral clearing of India's sterling credits through the machinery of the proposed International Fund and Bank is ruled out for all practical purposes, the prospect of Great Britain increasing her indebtedness to the U.S.A. to meet India's claims appears to be chimerical. In fact India has been bluntly told that 'Great Britain will have quite enough to do after the war without borrowing from U.S.A. and increasing her indebtedness in that direction merely to meet India's claims'.[16] Repudiation of the multilateral convertibility of sterling balances cannot be more clearly and bluntly expressed. Not quite on a par with this extremist attitude is the suggestion of Keynes that the only satisfactory solution is for India to reduce her sterling claims to reasonable proportions. 'The bigger the claim, the smaller the chances of India's converting it from its blocked character into a multilaterally convertible asset'. If the claim is not reduced, sterling will have to be depreciated to meet the balance of payments position. Great Britain could never allow this to happen. Besides, India's own interests will be threatened owing to the depreciation of

15. A speech delivered at a meeting of the Rotary Club, Bombay on the 3 October 1944.

16. *The Financial Times*, 11 July 1944. In the 'twenties the U.S.A. investors lent money to nations for the purpose of financing unilateral transfer of funds. Ultimately when the flow of credit from the U.S.A. ceased a large proportion of the newly contracted loans were in default. It is unlikely that the United States of America will repeat the folly.

the rupee in terms of gold or dollars. But on the other hand, what are the chances of repayment of sterling balances in the form of British-made capital goods? The *Manchester Guardian* has estimated that the service of interest and amortization to India, in respect of India's sterling credit, could hardly be less than £30 million yearly. Making allowance for the loss of the annual income from India's pre-war sterling debt which has been extinguished, 'in order to honour her obligations Britain must export to India in future twice as much as in the 'thirties, and it is obvious that the Indian market could not absorb such a volume of British goods unless a great deal went into the planned expansion of capital equipment'.[17] But could such a large export surplus be sustained by Great Britain's balance of trade position after the war?

The issue of repayment of sterling debt is not merely the question of Great Britain's capacity to pay after the war, but has now been complicated either by extraneous considerations or by the question of so-called equity. It has been argued that the Indo-British Financial Agreement concluded in February 1940, by virtue of which India's sterling credit was mounting up at the rate of £250 to £300 million a year, has been unfavourable to Great Britain and must be revised. According to this agreement India has borne during the war the cost of her pre-war forces, increased by rises of pay and prices, the normal cost of external defence troops and the contribution of ten million rupees per annum towards their extra cost while employed overseas. India has also borne the cost of local measures of defence including the cost of raising and equipping large bodies of Indian troops, the pay of all British forces stationed in India and the cost of aerodrome construction and military works of the Royal Indian Navy. In addition reciprocal aid has been afforded in India, and supplies, foodstuffs and raw materials have been furnished to America for war purposes. 'The sums borne by India under these heads up to 31 March 1944 were approximately £600 million, and the costs were then running at about £225

17. *The Manchester Guardian,* July 1944.

millions a year.'[18] The total defence expenditure in India during the four years prior to 31 March 1944 has been £1268 millions of which the British share has been £523 millions and India's share has been £545 millions. One of the poorest countries of the world, India had a pre-war defence budget of £54 millions which used to absorb the lion's share of the Central revenues. In 1944 'the costs were running at about £225 million per year'. It cannot be fairly said that India has not borne a fair share of the burden of defence expenditure. Nor can it be seriously maintained that India's capacity to pay was not adequately assessed when her share was determined in 1940. A more ingenious variant of the same argument is that, since India has already borne the real cost of the war in terms of effort and sacrifice, 'if the financial settlement were revised' it would not really increase the real burden on the people (Keynes). If we exclude the portion of Indian war expenditure met by rupee loans, the burden of which has been largely thrown upon posterity, the present generation has borne not only the equitably assessed share of war expenditure to the limit of its real capacity, but also a tremendously large real burden imposed on it through taxation by means of inflation. That the incidence of such taxation is regressive and has fallen on those least capable of bearing it, is an additional reason why, in all fairness, the sterling balances should be liquidated in the interests of the economic rehabilitation of the masses of the population. It may be contended that India has gained the advantage of an expanded industrial system, a larger volume of employment, a highly developed industrial skill and enterprise, and a rapidly growing war wealth of the war profiteers. Following this train of thought, some have even gone to the length of saying that India's sterling balances are nothing but war profits. But it is precisely because India's productive capacity has not sufficiently expanded to keep pace with the tempo of demand that we have witnessed the worst effects of inflation; in fact the crude method of inflation was justified by

18. Mr. Amery's statement before the House of Commons on 8 June 1944.

the necessity of wringing out productive capacity and resources from a low-level, backward economy unprepared for war. Taxation of war wealth and capital levy may have to be used as fiscal instruments after the war to redress inequality of sacrifice imposed by war-time inflation, but the financial counterpart of the sacrifice represented by sterling balances should be borne by Great Britain as some compensation for the unmerited suffering inflicted upon the masses of the population during the war.

A few other arguments may also be briefly examined in this connexion. One argument for freezing the entire debt, and not merely for partial repudiation of it, is that the sterling balances should remain blocked or funded so long as a situation similar to that under which it came into existence did not arise in relation to India. Critics who use this argument should remember that India does not claim these balances back just as a commercial debt, or just to take advantage of Britain's financial embarrassment after the war, but to create the minimum conditions of economic progress for the masses of India—a need which is as desperate as that which created this indebtedness for Great Britain. Another argument, which has appealed to some but has little weight, is that after all the sterling balances represent a part of the reserve which is held as cover against the Indian paper currency and are not as freely disposable as one would wish. This point requires clarification. India's paper currency reserve is maintained in the form of A including (1) Gold coin and bullion and (2) Sterling securities; and B including (1) Rupee coin, (2) Government of India rupee securities, and (3) Internal bills of exchange and other commercial paper. Since there is no maximum limit to the proportion held in sterling securities (the *minimum* under the law being 40 per cent.), the position, for example, on 9 June 1944, was that out of the total note-issue of Rs. 927·71 crores (as against Rs. 172·44 crores on 1 September 1939) there was a backing of Rs. 822·84 crores in the form of sterling securities. Thus the proportion of A to liabilities of the Issue Department, which is an index to the safety of the note-issue, already exceeded 92 per cent and was needlessly excessive as judged by modern standards. During the period in which America

absorbed gold flowing from many countries, she *sterilized* it and prevented it from raising the level of domestic prices by increasing the reserve ratio and thus holding an excessively large quantity of gold as cover against the note-issue. The Reserve Bank of India has absorbed such a large quantity of sterling that in spite of the gradual rise in the reserve ratio (from 63·14 per cent on 1 September 1939 to more than 92 per cent in 1944) sterling has not only been not sterilized, but its increasing accumulation has brought about the havoc of inflation. Obviously it is by lowering the reserve ratio and changing the composition of the paper currency reserve through the replacement of sterling securities by gold or silver, or by Government of India rupee securities, that the sterling balances can be liquidated. The entire amount of sterling securities cannot thus be liquidated in any circumstances, and so long as the link of the rupee with sterling continues a substantial part of the reserve may have to be held in sterling. But a large part of the sterling reserve can be liquidated without endangering the safety of the note-issue. How much of the sterling balances would be naturally blocked without Britain freezing any part of it, would depend upon the reserve ratio which the Reserve Bank chooses to fix after the war and the proportion of the reserve which it may decide to hold in the form of sterling. It must be noted, however, that the technique of converting sterling balances into foreign exchange which should be meant not for buying gold or silver bullion (to be kept as bullion or rupee coin) to increase the metallic portion of the paper currency reserve, but for buying capital goods for economic development, is to replace sterling securities by *ad hoc* Government of India securities. There is no reason why these *ad hocs* should not be absorbed by the public if the liquidation is gradual. Hence it is not necessary to suppose that liquidation of sterling securities would imply drastic deflation of currency and upset the apple-cart of planned economic development after the war. A certain degree of contraction of currency is inevitable after the war. But the Reserve Bank can contract currency irrespective of the liquidation of sterling balances, because the link between the liquidation of sterling balances and contraction of currency would be optional and

not obligatory. It is necessary in this context to refer to the change in the procedure of holding sterling balances which was noticed in 1944. During this year these balances began to figure as an asset of the Banking Department entitled *Balances held abroad,* rather than as an asset of the Issue Department in the category of *Sterling Securities.* For example, during the week ended 29 September 1944 *Balances held abroad* had increased by Rs. 14·74 crores and stood at the record figure of Rs. 304·81 crores, while the total amount held as sterling securities remained unaltered. The explanation of this change of policy may be that inflation had already reached its peak, that this new policy was necessary as a counter-inflationary measure, and that the proportion of external assets to total note-issue which had already exceeded 90 per cent could not possibly go still higher. Whatever the explanation, it is quite clear that sterling was accumulating as a free balance disposable through the banking process, and not as a long-term obligation.

The controversy on the future of India's sterling balances, while it has generated a good deal of irrational sentiment and not a small degree of bitterness and misunderstanding, has at least served the useful purpose of revealing the basic facts of the post-war economic situation which should be a guide to the formulation of the general principles of reconstruction of India's foreign trade. Economic realism demands the recognition of the fact that India should not set much store by large sterling balances being made available to her for her economic development during the period of transition from war to peace. International debts can only be settled in gold, in foreign investments and assets held abroad by the debtor nation, in goods and services entering into 'current transactions', and (what is most unlikely) through incurring of fresh indebtedness. Great Britain has 'little or no gold' to spare. She is not expected to part with such overseas investments as still remain, in view of her grave balance of payments position after the war. It will be impossible for her to repay sterling balances by increasing her indebtedness to the U.S.A. Her debt to India can, therefore, be paid through current transactions in goods and services. But her capacity to pay, which will determine the average annual rate

of liquidation of sterling debt by way of interest and amortization, can be determined only when Britain's balance of trade position becomes clear as the result of a proper evaluation of the loss of her foreign investments and assets during the war, of the prospects of British export trade, and of the liability which the Beveridge Plan of over-all social security will impose upon her strained resources.

It may be granted that whatever Britain can reasonably repay will have to be paid in goods and services through the normal mechanism of international commodity trade. But should repayment necessarily be directly in the form of British goods and services? To all intents and purposes, it seems to have been already assumed that India's sterling balances will be liquidated on a bilateral basis, and the quantity, prices, character and priority of goods in which India's sterling credits will be paid, will be a matter of bilateral negotiation and agreement between Britain and India.[19] A bilateral settlement of debt obviously implies that India must plan a direct import surplus in relation to Britain. In fact Sir C. D. Deshmukh, Governor of the Reserve Bank of India, said in the course of a speech already referred to above:

> 'We ought to get busy with our planning and consider what sort of controls and exchange rate would be appropriate in the circumstances of the case, the objective being the establishment of a suitable surplus of imports from the United Kingdom over exports, representing the repayment of our sterling balances'.

But it would be a serious folly to ignore that exchange control and regulation of trade have wider implications, and their character cannot be determined merely by the necessity of inducing an excess of commodity imports over exports in

19. A good deal depends upon the character and priority of goods to be imported. The sterling balances can be theoretically paid in consumers' goods, or intermediate products, or capital goods, or through export of technical skill and patent rights based on migration of industrial organization including factors of production. Transfer of a part of the military equipment and of the British Navy (as was suggested recently) to build up India's independent defence organization may easily absorb a considerable portion of her sterling balances.

relation to the United Kingdom. If exchange control (not only through the manipulation of the rupee-sterling rate, but also through the appropriate control of sterling) and regulation of trade (through quotas, priorities for British goods, price agreements, bulk purchase, etc.) are devised in the context of a general plan of returning to a preferential system which is devoid of such safeguards as were suggested in chapter 3, they will be clearly detrimental to India's wider economic interests, although they may create a 'suitable surplus of imports from the U.K. over exports, representing the repayment of our sterling balances'.

It is necessary to pick up the threads of our discussion before we pass on to the next stage of our analysis. We have already seen that the needs of economic development in general, and of capital development in particular, require the importation of capital goods (and the reduction of imports of consumers' goods including 'Treasure' to the minimum) (1) through the utilization of such sterling and dollar balances as become available, (2) through the importation of foreign capital and (3) through the export surplus which India may succeed in maintaining in relation to particular countries and which should be subject to multilateral clearing. We have already discussed the bearing of external balances on the dynamics of our foreign trade and our balance of payments after the war. It remains now to concentrate our attention on (1) the necessity and the probable prospects of borrowing capital for internal economic development, (2) the implications of reducing imports of consumers' goods (including imports of 'Treasure') to the minimum, and (3) the general problem of creating a stable basis of export trade.

The necessity of borrowing foreign capital to finance economic development is clearly realized by those who have grasped the colossal nature of the problem of planned welfare in India. It is true that after the war India will be left with a stronger and broader basis of capital development which will be the foundation of further economic growth. But the process of restocking and re-equipment and of repairs and renewal of machinery and plant which have been put to abnormal strain during the war, will absorb a very considerable part of the capital which industries will command

after the war. Since the income-tax legislation has until recently discouraged the transfer of more than the minimum amount of undistributed profits to the reserve funds of industrial companies, it is very unlikely that after the war industries can practise 'self-financing' (which has become a recognized method of industrial finance in modern countries) to any significant extent for the purpose of industrial expansion. At any rate even the authors of the Bombay Plan who, as leaders of rising industrialism in this country, cannot be expected to take kindly to the importation of foreign capital, have realized that the dimensions of the problem of financing any plan of economic development which would catch the imagination of the masses and call forth the necessary sacrifice, are so colossal that foreign capital as one of the external sources of finance cannot be ignored.[20] That is why they have planned for foreign borrowing to the extent of Rs. 700 crores during the planning period of 15 years. In fact if India is determined not to be doomed to long-period economic stagnation on a very low standard of living, she cannot wait for the process of voluntary and spontaneous saving to procure a supply of capital sufficient to give a strong upward lift to her economic development. Hence to execute a national plan of economic development she will have to adopt a State-planned policy of saving and investment and combine into one pattern of centralized planning the maintenance of high standards of efficiency, long hours of work, low standards of living irrespective of efficiency of production, an inflationary credit policy accompanied by the strictest price control, a high protective tariff and complete control of foreign trade. The assistance of foreign capital will obviously ease the economic strain and privation of which India has already had a full share during the war. Moreover, the importation of patent rights and processes, technical personnel

20. 'It is one thing to furnish a very thin upper layer of society with every luxury. It is an entirely different thing to raise, *however slightly*, the standard of living and even the elementary cultural needs of huge masses of the population' (G. T. Grinko, Vice-Chairman, State Planning Commission of the U.S.S.R., in his *Five-Year Plan of the Soviet Union*).

and even entrepreneurs will be necessary to avoid inevitable bottle-necks created by the local scarcity of these resources, if the pace of economic development has to be even tolerably rapid. A free India can easily ensure that imported capital and skill do not fail to contribute to the training of responsible local leadership commensurate with the expansion of economic life.

There are two arguments which may be advanced against foreign capital from the point of view of the long-range planning of economic development. It may be argued that foreign capital creates vested economic interests which seek to build up a pattern of industry and trade that is detrimental to the best interests of a country, or at least thwarts the development of productive forces according to a national plan. Has not India emancipated herself from the domination of foreign vested interests through the repatriation of sterling debt? Will it not be unwise to undo what has already been achieved? A second argument may be that since movements of capital and settlement of financial claims are closely bound up with commodity trade in a net-work of multilateral exchanges, and since interest rates, exchange rates, commodity prices, or other elements of price structure in one country are brought into relation with similar elements in other countries, if India imports foreign capital and is drawn into a system of multilateral trade, her internal economy cannot insulate itself against international economic (particularly monetary) and political disturbances.

It should be abundantly clear to nations that isolationism in the economic as well as in the political field will become outmoded anachronism for compelling reasons even from the narrow national point of view. Is it not absurd to suppose that India can practise economic isolationism and yet hope to secure a satisfactory liquidation of her foreign credits? The U.S.A. tried this expedient after the last war with disastrous consequences for herself and the rest of the world; but then she obtained repayment in gold and not in capital goods which India so badly needs. Moreover, obtaining the means of economic development through an export surplus (which is another alternative) presupposes international economic co-operation based on a system of in-

ternational trade. But these arguments do not imply that India should not naturally desire to keep her hands free to follow whatever economic policy might seem necessary in an emergency. National planning is not necessarily inconsistent with international co-operation in the sphere of trade and international lending.

But it may be legitimately argued that the theory set forth above presupposes (1) that all nations, industrially advanced as well as economically under-developed, should be in a position to plan economic security and stability and 'Full Employment' within national boundaries; and (2) that economically backward countries should not be hampered by the 'exploitation' of international financial enterprise controlled by the industrially advanced nations. Will these assumptions be justified in the post-war world?

The answer to this question turns on the changed conditions under which international lending is likely to be resumed in the post-war years. Most countries will need capital for economic reconstruction, and many like India and China with their vast economic potentialities, will need capital for economic development. In these circumstances if international lending is dominated by international finance capital and 'power economics', foreign capital will not play a beneficent rôle in the changing economies of these countries. But there are reasons to believe that the machinery, methods and objects of international lending will be different from what they were in the heyday of expansion of capitalism (if capitalism is to survive at all). The object of international lending now will be to raise the level of economic life in economically underdeveloped countries and to assist the process of economic rehabilitation and reconstruction in devastated areas, out of a motive of enlightened self-interest, viz., creating in these countries a wide market for the high-grade manufactured products of advanced industrial countries and for the technique, skill, enterprise and guidance which they can spare. Since this would be an object of common interest, the machinery and methods of international lending will have more of an international character than before, or will at least be amenable to proper regulation and control.

It is not unreasonable to anticipate that after the war international lending will be associated with international organizations set up for the planned economic development of backward regions. Recently the *Economist* discussed the potentialities of an organization of the type of the Middle East Supply Centre which has been engaged in the planning of war economy in the Middle East. This organization, which has been a joint Anglo-American venture since 1942, is chiefly responsible for regulating the flow of supplies into this area. Men working in it are chiefly young technicians and scientists. The Centre has planned various agricultural projects and improvements, and has many achievements to its credit. It has been responsible for afforestation, for successful experiments in the growing of seed potatoes and the introduction of early-growing Palestinian wheat into Iraq and Iran; for provision of agricultural machinery, for three new schemes of irrigation which are being operated in Persia, and for locust control. The Centre has already raised the standard of public health through its health services. It has created new industries and assisted the local transport services. The Centre has become a pool for all kinds of economic, social and technical services and has been solving problems which concern many States. After the war planning could easily cover schemes of capital development. Roads, irrigation schemes, artesian wells, industrial development, all crossing and recrossing national frontiers, could be planned by this Centre, and these could give an economic unity to the Middle East which it has so far lacked. The *Economist* believes that a Centre of this sort, adapted with necessary modifications to local conditions, can effectively serve the economically backward regions of the world. 'That such a development would serve the cause of interdependence cannot be doubted. American participation is already a guarantee of its international character. Russian support would strengthen it still more.' It is most likely that the long-term capital transactions would remain subject to international control which implies some international authority to supervise and recommend foreign investment transactions. The activities of the U.N.R.R.A., which would result in the growth of international organizations for handling common problems of rehabilitation

and reconstruction, may also play an important part in regulating the flow of international capital investments in a rational manner. Similarly the proposed International Bank will also be expected to regulate the flow of international loans so as to serve the cause of economic interdependence of nations. Even if these hopes are frustrated, international movement of capital will at least be controlled by borrowing and lending countries alike. As Condliffe says, 'long-term investment across national boundaries now requires government approval in most capital-exporting countries and in many capital-receiving countries.'[21] It will, therefore, be possible for a debtor country to conclude agreements which regulate foreign borrowings according to the requirements of internal economic development, monetary stability or economic freedom. A creditor country can similarly obtain an adequate guarantee in respect of the safety and stability of its investments and can safeguard itself against confiscatory policies and discriminatory taxation imposed particularly upon foreign capital.

A few other aspects of the resumption of international lending under changed conditions after the war have to be particularly stressed, since they have an important bearing on the reconstruction of India's foreign trade. It is probable that a principle analogous to that of Lend-Lease will apply to a considerable portion of international development loans which cannot be 'placed' through the proposed International Bank. Repayment will be demanded not in gold and interest-bearing securities, but in goods and services.[22] Thus export of foreign capital to India is likely to be backed by the incentive to buy from India, so far as interest and amortiza-

21. Condliffe, *Reconstruction of World Trade*, p. 98. Condliffe points out how before the war export of British capital required the permission of the Treasury Committee. 'If permission were given, which is rather rare for countries outside the Sterling Area, it would be conditional upon the loan being spent for the purchase of British exports'.

22. It was Germany that first adopted the method of securing interest payments on her capital exports in kind from countries of south-eastern Europe. She was careful to see that these countries developed an economy which would be complementary to Germany's.

tion are concerned. This type of foreign loan will obviously require the utilization of India's export surplus for its service as well as eventual repayment. Secondly, the system of transferring a loan of capital in the currency of the debtor country which broke down after 1931 is not likely to be restored during the transition period after the war. The reason why this system absolutely broke down was that a foreign loan which involved an exchange of the lending country's currency into the currency of the borrowing country imposed a strain upon the lending country's balance of international payments. Since the borrowing country spent the proceeds of the loan in other countries, the lending country needed to expand its receipts from exports or to contract its payments for imports in order to offset its capital payment to the borrowing country. In a world in which there were barriers to exports to other markets such adjustments were difficult. Hence many countries banned or discouraged foreign lending either directly or through the mechanism of exchange control. Thus since 1931 there has been an embargo upon foreign capital issues in the London capital market. Before the present war, as Condliffe has pointed out, the Treasury Committee in Britain which gave permission for sterling loans negotiated by countries of the Sterling Area only, made it 'conditional upon the loan being spent for the purchase of British exports.' And the most likely way for the loan to be supplied was utilizing the machinery of the Export Credits Guarantee Department. It is fairly evident that, for reasons just explained as well as for other reasons, the U.S.A., which has increased her productive capacity by 50 per cent during the war and accounts for nearly one-half of the total production capacity of the world, and will, therefore emerge from the war as the greatest creditor nation, will oppose any plan of multilateral utilization of the proceeds of American loans by debtor countries. Mr. Harry Hopkins, Personal Adviser to President Roosevelt, writing in an American magazine, said: 'We should not again make the mistake of the 'twenties when we made loans to foreign governments which spent money in their own countries instead of in the United States.' According to Mr. Hopkins, American post-war loans to foreign governments will run into several

pression of the 'thirties capital movements were taking place in the form of such direct investment, although few prospectuses of foreign issues were visible. In 1935 British and American industries jointly set up an important chemical and textile plant in Argentina involving an investment of 10 million dollars. American oil companies transferred capital to Columbia to the extent of 30 million dollars in 1937, 1938 and 1939. Tyre and rubber factories have recently migrated from the U.S.A. to Argentina, Brazil and Chile. Another factory is launching on a new enterprise in Brazil jointly with Brazilian capital. Direct investment has taken many forms 'such as, for example, the purchase of shares in a foreign enterprise by a great corporation wishing to enter the foreign market, the establishment of branch factories, or the floatation of new enterprises in which the parent corporation retained a minority or majority interest. Nearly always the right to use patented processes or devices was part of the arrangement.'[24] International movements of capital which take such forms would be a fruitful cause of economic conflict, unless they are controlled and regulated either by an international authority or by agreement between the creditor and the debtor countries. In the early days of socialist construction Soviet Russia entered into agreements with various foreign firms providing for construction of automobile plant, tractor plants, metallurgical and chemical enterprises, etc., and took advantage of competition amongst capitalist countries in getting foreign credits on favourable terms. The abolition of private capitalistic enterprise, however, prevented capitalistic countries from gaining a foothold in U.S.S.R. by a process of slow economic penetration. It cannot be denied that in the absence of international control, investment of capital by advanced industrial countries in economically backward countries, whose bargaining power is weak, may easily lead to the development of so-called complementary economies which would not be a means of extending international trade, but, as in the case of Nazi Germany, a method of binding weaker countries

24. Condliffe, *Reconstruction of World Trade*, pp. 342-43.

as agrarian dependencies to the economic power of a dominant, industrial nation.

We have next to discuss the implications of reducing imports of consumers' goods (including precious metals which India tends to absorb readily) to the minimum as part of the broad economic policy of planned development of welfare. As already said, an orgy of national expenditure on imported consumers' goods and precious metals and the impinging of a large amount of the hitherto immobilized purchasing power on the freer circulation of such commodities after the war may result in disastrous inflationary consequences. Apart from the necessity of avoiding inflation, no plan of economic development can succeed in these circumstances in which India will find it difficult to import sufficient quantities of capital goods at reasonable prices. Hence it would be necessary to continue the system of war-time import control based on the distinction between essential and non-essential imports. At the same time exchange control will have to operate in such a manner as to make it possible for India to obtain the necessary means of economic development at reasonable prices. Moreover, the import of gold and silver will have to be reduced to achieve the same object. If such measures are not taken, a plan of economic development may have to be abandoned, while India may witness the spectacle of dissipation of hard-earned external balances in current consumption and/or serious deterioration in the terms of trade reacting adversely upon the real income of the masses of the agricultural population.

It should be apparent that import control contemplated in this context must be conceived as an instrument of planning economic development and creating the minimum conditions of economic progress in a country in which the major section of the population occupies a sub-human level of existence. Such economic planning involves a national sacrifice of present consumption for the sake of a higher general level of welfare in the future. This sacrifice would naturally take many forms. The nation has to mobilize all its resources which could otherwise be spent on current consumption. It has to absorb a considerable part of its current income to provide the necessary means of economic and cultural development,

A part of what is absorbed from the national income will have to be exported in the form of goods to obtain the necessary imports of capital goods. In terms of physical production this would mean diversion of factors of production to the production of such goods as can find a market abroad. Necessarily imports of consumers' goods have to be reduced to the minimum. It is quite obvious that in the present context the reduction of imports of consumers' goods implies stinting of current consumption which represents the real cost of national economic development. Many countries are known to have recently built up their industrial equipment and power base by an enormous national sacrifice in the way of curtailment of the importation and domestic production of not only the non-essential luxuries, but also most of the semi-luxuries and even some of the necessaries of life. But economic sacrifice to be really national in character must be generally and equitably diffused in the entire community. From this point of view mere high tariff protection as an instrument of planned industrialization is, *in the absence of a unified plan of economic development,* manifestly unfair to large sections of the population and tends to generate or intensify class conflict. General protection tends to raise the level of incomes and costs in the protectionist country as compared to the level of incomes and costs in other countries. Hence it tends to make all its products comparatively dear to the extent required for the restoration of international equilibrium, and the export industries of the country find their competitive advantage reduced. Since these price adjustments do not ordinarily affect one-sided transfers of wealth, the balance of payments would tend to be restored by a contraction of exports.[25] In the case of India such a process would immediately hit agriculture and the vast masses of the population dependent on it. Economists nowadays agree that, in a country in which there is a vast amount of permanently unemployed resources, protection will bring about a net increase of employment rather than a mere diversion of it from other industries to the protected industries. But

25. Barret Whale, *International Trade*, pp. 130-31.

without a plan of economic development a more than compensating increase in the demand for labour in new industries, while employment in the export industries is reduced, would be fruitless in so far as the existing supply of labour would be of the wrong type and in wrong places. There would thus be a danger of dividends and wages in protected industries being boosted up at the expense of the real incomes of the major sections of the population and without compensating benefits in terms of employment.[26] Continuance after the war of import controls, designed to reduce imports of consumers' goods to the minimum and to replace them by capital goods, may afford almost complete over-all protection through import prohibition to domestic industries, and, at the same time, solve the problem of obtaining imported plant, equipment and also perhaps patents and technical aid on favourable terms. But in this case the effects of protection in diminishing total imports, and, therefore, total exports, will be lessened, because the purchasing power set free from current consumption (or received by the State from protective duties if the method of tariff protection and not that of import prohibition is adopted) is diverted to the purchase of means of production. Hence agricultural interests will not suffer so seriously as they should in the absence of any plan by which imports of consumers' goods would be replaced by imports of capital goods. But protection of a comprehensive character is associated with inflationary phenomena. Price inflation as well as profit inflation which has occurred during the war period will have to be moderated in the post-war period. This will be one of the most difficult tasks of economic

26. Mr. A. J. Brown in a pamphlet on *Industrialization and Trade* (Royal Institute of International Affairs, 1943) cites the case of Australia and comes to the conclusion that industrialization in that country between 1915 and 1938 did not contribute greatly to the growth of Australian income. Output per head (measured at world prices) in the non-food industries had a tendency to replace certain kinds of imports rather than to increase income. Industrialization was not justified by income results and in terms of net employment induced by economic change. India has naturally to guard against such a danger.

planning in India. Still there is no doubt that the dynamics of mild inflation will be a conditioning factor in the process of transition of a low-level economy to a higher level of increased welfare and increased social productivity. Nevertheless, if things are left to the free play of private enterprise, the growth of new industries will tend to increase the disparity between the industrial and the agricultural prices and incomes. The burdens and benefits of economic development will be inequitably distributed amongst classes and groups, leading to accentuation of class conflict. Such a situation can never be tolerated by a real people's government. Hence it should be clearly understood that the reduction of imports of consumers' goods should be viewed as a national sacrifice which should be fairly apportioned amongst different classes according to the principle of ability. The sacrifice of that part of the real income of the country, which is withheld from current consumption and is devoted to the production of internally produced means of production, should also be similarly distributed. The concrete questions of economic policy which will arise will be whether an equitable distribution of the burden and benefits of planned economic development should be brought about through capital levy, levy on war wealth, inheritance tax, limitation of dividends, etc., and through provision of direct subsidies and of free social services of an elementary character for the masses of the agricultural population, or whether more radical measures of financing the economic plan would be necessary and practicable. Before a plan like the Bombay Plan can be freely accepted and executed by a people's government these fundamental financial issues have to be decided in such a way as to ensure elementary distributive justice in a free community which seeks to build up productive power required for a high-level, expanding economy. How far the nation is prepared for such enormous sacrifices in terms of real income after the privations of the recent war, and how the financial burden of planning should be distributed, would naturally depend upon the economic decision of the common man. But such a national effort is worth making in this, as in every other, country, if 'freedom from want' is to become a reality for the common man.

We may now define the general principles underlying the policy of building up a stable structure of India's export trade. In the earlier part of this chapter it was argued that India's economic safety lies in abandoning the autarchic and restrictionist policies which are the outcome of crude economic ideas. India urgently requires planning of her export trade not only in the interests of agriculture, but also to obtain the capital requirements of planned development of welfare. The general basis of agricultural planning in relation to our export trade was indicated, as the readers will recall, in chapter 1. The export trade of India is comparatively well diversified and ranks in this respect with that of Canada and Norway. But the risk inherent in specialization (which consists in fluctuations in national income due to shifts in foreign demand) in the case of countries specializing in primary production, depends not only on the range of specialization, but also on the nature of commodities exported. India's export trade has an unstable basis, because the character of her export goods is such that their prices have shown a tendency to wide and simultaneous fluctuations. In this respect she is in the ranks of tropical countries and should be particularly classed with the Dutch East Indies. A study of the trend of exports shows that before the war it was possible for India to improve the distribution of the exports of raw cotton, linseed and hides and skins amongst the different markets, but it was scarcely possible to increase the total exports of any commodity, except raw cotton and linseed. India has lacked what Marshall calls 'resourcefulness of supply' or the capacity of adapting her export trade to shifts in international demand, and, at the same time, has been exporting goods which normally face inelastic demand particularly in periods of economic depression. It is true that India's economic difficulties were accentuated by the severe restriction in the area of the free international market, glutting of this market due to trade restrictions as well as increase in the quantum of agricultural production, and deterioration in the terms of trade caused by the pressure of unilateral transfer of funds upon her export trade. These abnormal causes may not operate in the post-war world. But the clear lesson of economic history is that economic planning in India must be

aimed at counteracting what Henderson calls the 'exploiting agencies,' viz., the 'tendencies working through the blind forces of supply and demand to reduce the prices of tropical products to unremunerative levels,' the beneficiaries of this exploitation being the consumers of industrial countries. These 'exploiting agencies' have to be counteracted by industrial development, by changing the character of our exports in such a way as to stabilize the basis of our export trade, and by evolving a reasonable degree of resourcefulness and adaptability of supply. This opinion may appear to be an economic heresy at first sight. But readers should note that even modern economists who believe in the principle of free trade have admitted the necessity of protected industrialization in the interests of the economic stability of purely agricultural countries. Barret Whale in his *International Trade* admits that a country tends to have an unstable internal economy when the 'growing demands of the community' are left to be satisfied 'through the exchange of a very limited range of exports,' and when the demand for these exports is inelastic and is also subject to wide fluctuations. In such a case 'in the general interest some sacrifice of average prosperity may be warranted as a kind of insurance premium.' But since such a country would continue to have an important stake in the export trade—we have demonstrated that this is true of India—economic policy 'should be directed towards diversifying exports *at least as much as* towards making the country more self-sufficient.'[27] This is a problem which requires for its solution careful research and judicious planning. But it is not difficult to visualize the change in the character of India's exports as she advances to a higher stage of economic development. We have argued in chapter 1 that India must leave the ranks of tropical countries and reach the economic stage characteristic of advanced primary countries. What does this process mean in terms of import-export equilibrium? Agricultural countries become industrialized by stages. They begin by producing coarse qualities of finished goods and semi-finished products which

27. Barret Whale, *International Trade*, p. 155. The italics are mine.

demand no skilled labour. Thus instead of crude raw materials and food products they come more and more to export processed raw materials and food. Chilled meat replaces cattle, flour replaces grain, crude copper or iron replaces ore, cellulose and paper replace wood. This development naturally involves a great saving in transport costs. But the finer qualities of many goods, together with means of production, such as machinery and stores, have still to be imported. In the older industrial countries there is progress and reorganization of production. They turn to the production of more complicated machines, electro-motors, motor cars, aeroplanes, wireless apparatus, finer textiles, photographic and other optical goods, measuring instruments and other 'high-income' goods and high-grade products. In general the experience has been that as countries modernize their economic structure they import more of all the major classes of commodities.[28] They import more foodstuffs, more raw materials, more semi-manufactured, intermediate products and more finished goods, but imports of raw materials and intermediate products increase in *relative* importance. On the export side a country like India moving to a more developed stage of economic life begins to export more of finished and semi-finished goods. She is likely to increase her exports of crude materials and foodstuffs, but these may decrease in *relative* importance. It is a common fallacy to suppose that industrial development in an agricultural country leads to a decrease in her imports of manufactured goods. Rising incomes make it possible for people in such a country to buy more of 'high-income,' high-grade goods. Also imports of equipment and parts of industrial plants and public utilities are likely to increase, while international specialization by stages of manufacture is bound to be reflected in increasing imports of 'semi-manufactures.' It must be admitted, however, that *all* countries at the *same* time cannot raise the ratio of raw to manufactured products on the import side, and lower it on the export side. But, as

28. Eugene Staley, *World Economic Development* (International Labour Office), Chapter 8.

things are, the disparity of economic development in the ranks of the so-called 'agricultural' countries will be so wide that a situation like this is not likely to adversely affect 'access to raw materials' in the immediately foreseeable future. On the whole, while it is a mistake to assume that industrialization of agricultural countries spells economic disaster for industrial countries, it is also obvious that, while an agricultural country industrializes herself, she reaps the benefit of a favourable change in the character of her exports and may still find an increasingly wider outlet for an expanded volume of exports. Hence it is possible for India not only to maintain her export tradê at a high level, but also to build up a stable structure of export trade and, with it, a stable internal economy.

We must hasten to point out (even at the risk of redundancy) that what was just discussed is the problem and possibilities of long-range economic planning and particularly agricultural planning. The dynamic changes visualized in the last paragraph cannot occur in the transitional period following the war. An alternative way of keeping our exports at a high level is increasing the quantum of exports at a decreasing cost per unit. This would also depend upon agricultural development involving long-range planning and is a method of adjustment which cannot be relied upon in the period immediately following the war. But as already explained at an earlier stage of the argument presented in this chapter, there will be certain favourable conditions which an alert and resourceful economic policy can exploit after the war to maintain our export trade at a high level even in the transitional period after the war. The international market just after the war would be a 'sellers' market' with a colossal demand for primary and semi-processed products required for rehabilitation and reconstruction, impinging upon a comparatively short supply. The demand created by re-stocking and re-equipment of industries will be such as to create almost a temporary boom in the sphere of primary production. It is also very likely that countries specializing in primary production for export (agriculture, mining, forestry, dairy farming, etc., not only in tropical countries, but also in advanced primary and industrial countries like

Canada and the U.S.A.) will have a big say in determining the conditions of international exchange. The widening disparity between the prices of industrial products and the prices of primary products, which has been an agency of exploitation of primary producers all the world over during the last generation, will be counteracted through the concerted efforts of primary-producing countries under the leadership of the U.S.A. which also has to plan the welfare of the large masses of her agricultural population dependent upon overseas export markets. In these circumstances India's export trade will share the stability of agricultural prices and incomes through international economic planning. Secondly, India will be in a position to export immediately after the war semi-processed raw materials and simpler types of manufactured goods to the neighbouring countries of Asia, Africa and Oceania. During the inter-war period this type of trade was a remarkable feature of India's foreign trade. During the recent war India's exports of manufactured products have shown considerable expansion due to the exigencies of the war. With the disappearance of the abnormal conditions which have made India a base of supply for a number of neighbouring countries, the volume of exports of consumers' goods will contract, not because of lack of demand but because in the interests of domestic consumers in India it will be necessary to prevent the impact of foreign demand from creating inflationary conditions and scarcity of essential consumers' goods. But still with proper planning it should be possible for India to export a certain amount of this category of goods to obtain essential imports. In any case immediately after the war to the extent that shipping is available India will be able to exploit the war-time expansion in the output of iron, steel, and other metals and of secondary products, such as steel plates and structural steel plates as well as the considerable development of actual machine-building and production of other metal manufactures. The Indian heavy industry (as well as Australian) is bound to play an important rôle in the rehabilitation and reconstruction of South China and South-East Asia, more particularly if capital goods cannot be imported from Europe or America.

The argument presented above should not run the risk of lending support to the theory that the possible development of India's export trade in the markets which are now not open to us, or difficult of access, will solve the problems of stability of income and employment during the transitional period following the end of the war. In the course of a speech delivered in the Legislative Assembly on 26 March 1945 in reply to criticisms of the Finance Bill, Sir Jeremy Raisman said: 'We shall have export markets open to us which at the present moment are either not open or are difficult of access. That will tend to fill the vacuum which is left by the cessation of war expenditure.' But he was careful enough to preface this remark by the statement that if the expansion of private economic enterprise (in the sphere of internal economic development) is on a sufficient scale, then 'it is possible that it may *completely* neutralize the effects of the cessation of Government expenditure,' and he hoped that 'that will happen to a great extent.' Thus apart from planned economic development, 'one of the policies,' according to Sir Jeremy Raisman, 'which it is possible to pursue is to regulate the pace at which we unwind our war economy, to regulate the demobilization both of men and materials and of industry generally.' The domestic economic policy needed for the stabilization of income and employment in India immediately after the war has various aspects which are not germane to the issues discussed in this book. But one fundamental aspect of it which is closely inter-linked with the planning of trade and must be discussed in this chapter is stabilization of the post-war price level. The strictly monetary aspects of this complex question will be discussed in the concluding chapter in which we shall examine the instrumentalities of trade control. But the best economic thought of the world today is inclined to the view that monetary policy aimed at the stabilization of internal prices (and output, employment and income) must be reinforced by a system of physical controls to yield effective results, specially in an emergency in which it becomes necessary to protect the economy of a country from the effects of the jolt which will come when colossal war expenditure ceases, even though it may be cushioned by slow and cautious unwinding of the war

economy. It is necessary, therefore, to discuss the general principles of physical controls in so far as they relate to both internal and external trade.

The most important element in the problem of price stabilization is the necessity of guaranteeing minimum prices of agricultural products. As Sir Jeremy Raisman said in the course of the speech from which extracts were quoted above, 'if you are to prevent a disastrous drop in the whole price structure, then one of the main things which will and which must engage your attention is the problem of maintaining minimum prices for primary products.' It is well known that agricultural prices are naturally more unstable than industrial prices. The period of production being longer in agriculture, maladjustment between demand and supply is amplified by the time-lag between changes in demand and appropriate changes in supply. In a period of falling prices farmers try to arrest a fall in incomes by increasing their output, but such a step accentuates the fall of agricultural prices. In a country like India in which farmers are ignorant of market conditions, and their ignorance, financial weakness and pressure to sell just after the harvest are exploited by dealers, the fall of agricultural incomes in a period of falling agricultural prices assumes a most tragic significance. Hence both elementary distributive justice and requirements of social security for the masses of the population demand that the State should guarantee a fair minimum return for their crops. Sir Jeremy Raisman was moved by these sentiments when he said that 'the government of this country after the war will have to maintain a sympathetic attitude towards the problem of guaranteeing a minimum return to the cultivator', and that 'the degree of hardship and misery which could result from a completely *laissez faire* attitude towards agricultural prices is too colossal to contemplate.' But it is not mere sentimental sympathy for the down-trodden masses which is the essence of the matter. It is quite obvious that without stabilization of agricultural incomes and employment which would result from the stabilization of agricultural prices, *either* expansion of output, employment and economic activity in other sectors of our post-

war economy will not be possible, *or*, even if it is possible, it will have an anti-social character and an unstable basis.

Stabilization of agricultural prices being a desirable objective, how can an appropriate trade policy be evolved which can be dovetailed into a programme of stabilizing agricultural prices? We shall discuss the general principles bearing on this question and leave questions of instrumentalities and technique of trade control to be discussed in the concluding chapter. It may be assumed for all practical purposes that the foreign market is an extension of the home market, while the home market is a small sector of the world market. Since world demand and world supply in respect of most agricultural products are very large in volume, normally the pull of both exercises a steadying effect upon agricultural prices in a single country through the process of international trade. An excessive supply due to occasional overproduction within the country would find an outlet in the world market. Domestic prices would remain stable, and if the surplus selling abroad forms an insignificant proportion of the world supply, world prices would also remain substantially the same. Similarly occasional underproduction within the country will call forth an additional foreign supply sufficient to stabilize home prices without raising the world prices of agricultural products. But if that country seeks to insulate her internal economy *completely* against external economic disturbances internal price fluctuations are likely to be much more violent (*assuming a free market economy*) than they would be under reasonably free trade. In any case since complete economic insulation is impracticable the practical issue is how possible changes in the world prices of agricultural products will be reflected with a time-lag in their prices in this country (and in the return obtained by the farmer), and how best it will be possible for us to guarantee minimum prices of agricultural products. There may be agricultural products in respect of which India may be a *net importer*. She may import certain kinds of raw material or food-stuffs and export others, but the quantum of imports may exceed the quantum of exports. On the other hand, there may be categories in respect of which India may be a *net exporter*, the quantum of exports of certain qualities

exceeding the quantum of imports of other qualities of the same commodity (for example, export of short-staple cotton and import of long-staple cotton). In either case if the quality imported is a high-grade product or satisfies a higher order of wants, the fall in the external price will mean a more favourable price parity for the foreign product, and the domestic producer may lose an appreciable sector of the domestic and the foreign markets unless he lowered his price. In these two cases as well as in the case in which the foreign product competes more or less directly with the domestic product, the domestic as well as the foreign producer generally has an equal stake in the stability of prices and the guarantee of minimum prices secured through international action. There are two other cases:—(1) the case in which the commodity is not produced within the country and is wholly imported, and (2) the case in which its production is the virtual monopoly of a country or group of countries. In both cases international commodity control schemes may be designed to assure mutual stability of prices, for producers benefiting under one scheme may be consumers benefiting under another.

It is necessary to comment briefly on the general principles of international commodity control schemes to which India may be a party and which will determine the success of any plan of internal stabilization of agricultural prices which India may adopt after the war. After the war the 'two-price' systems in respect of important agricultural products are bound to prevail. There is little probability that the prices of cotton and wheat in America will be allowed to return to the world price level. Even during the war stabilization schemes in respect of wheat and sugar have not been kept in abeyance. Negotiations for an international wheat agreement in 1939, interrupted by the war, were taken up later between the representatives of Argentina, Australia, Canada, the United Kingdom and the United States, and a Memorandum of Agreement between these countries was announced in Washington in July 1942. Pending the conclusion of a comprehensive international agreement after the war, provision was made for the control of production, stocks and exports, co-operation between the signatories in stabiliz-

ing prices and the constitution of a wheat pool for inter-governmental relief in war-stricken and other necessitous areas. Similarly attempts have been made to keep the international sugar agreement informally in force amongst the United Nations. Theoretically, the elimination of business cycles through international monetary co-operation can solve the problem of agricultural surplus, for if cyclical fluctuations in the volume of industrial production can be reduced and a steady level of sales of raw materials assured, the periodic restocking and destocking movements which accompany even minor variations in consumption and tend to amplify price movements, would be of minor importance. But, on the one hand, it is unrealistic to imagine that, even if the right type of international monetary control is evolved after the war, it will be equal to the task of coping with the amplitude of price fluctuations and wide disparities between the national price levels, and, on the other hand, the accumulating experience of the inter-war period clearly points to the necessity of reinforcing monetary measures with a system of physical controls operating according to an agreed international plan. Hence it has been realized that it is by means of international commodity control agreements that different national policies aimed at preservation of agricultural interests can be reconciled and a stable basis of international co-operation established. Otherwise, the alternative is international conflict involving subsidies, tariffs and discriminations. It is uncertainty in international trading relations which gives rise to trade barriers. For example, uncertainty regarding the quantities of Russian wheat thrown on the European market was an important cause of the rise of wheat tariffs in Europe in the 'thirties. On the other hand, assurance regarding markets is essential to necessary adjustments in the way of costs and shifts in production without which the problem of agricultural surplus, which may arise in an acute form after the war, cannot be satisfactorily solved. Industrial goods are produced on orders or contracts, and many classes of industrial employees can count upon economic security for specified periods, while trade unions have contracts regarding wages. Why should not the farmers be entitled to forward contracts guaranteeing to them a certain level of income

and employment? Now, if they win the right to forward contract they will have naturally to accept obligations in the matter of adjustment of costs and shifts in production in response to long-period dynamic changes. But diversion of production from a crop in respect of which there is a world surplus to other alternative corps and rational crop planning become possible on the basis of international commodity-control schemes. Apart from everything else, in so far as such schemes prevent the deterioration in the terms of trade of predominantly agricultural countries burdened with fixed debt obligations, the strain of economic disequilibrium is eased, and these countries cease to be the danger spots of the world contributing to instability of international economic and political relations.

Judged by past experience, international commodity-control schemes have serious limitations. They may degenerate into merely price-raising schemes which do not safeguard the interests of consumers. They may interfere with the piling of minimum stocks necessary in emergencies. Since natural raw materials will have to face the competition of synthetic substitutes to a much greater extent after the war, their success may at best be limited. So far as economic adjustments required for higher productivity of labour may be discouraged under the commodity-control agreements, wages may have a tendency to be frozen at low levels, and the interests of workers may consequently suffer. Lastly, downward secular changes in the price level of agricultural products may not be permitted to assert themselves. But human ingenuity need not be unequal to the task of devising safeguards against these dangers. Schemes may be contrived to ensure adequate supplies of food or raw materials at all times at reasonable prices. Adequate representation of consumers on international boards of control can also be guaranteed. Maintenance of minimum reserve stocks can also be ensured. Competition between the synthetic and the natural product may also be stabilized and adjusted on the basis of price agreement in order to give sufficient time to high-cost sections of agriculture to adapt themselves to the new situation, rather than face sudden loss of employment. Since the object of stabilization of agricultural prices should

be to eliminate price fluctuations over the periods of the business cycle, and an artificial level of prices which runs counter to secular changes in prices cannot be sustained without serious loss and dislocation, it would be necessary to ensure that price stability over short periods of the business cycle is not permitted to stand in the way of a possible downward secular trend of prices. Thus it should not be inevitable that commodity-control schemes would discourage economic adjustments required for the higher productivity of labour in agriculture. And the interests of workers in agriculture can be easily protected by a safeguarding clause providing for minimum wages and reasonable security of employment.

Stabilization of agricultural prices in India would require a domestic counterpart of properly integrated measures of control. General principles underlying these measures may now be briefly outlined. First, it would be necessary to devise a system of price control aimed, in the first instance, at preventing a deterioration of the terms of exchange between agricultural and industrial products. Guaranteeing a minimum return to the farmer in the face of technological progress in world agriculture and the opening up of new and cheap sources of supply (if not competition of synthetic substitutes) will involve subsidization of agriculture at the expense of the community till a long-range solution of the problem of stabilization of prices is found in (i) modernization of agricultural production and marketing, (ii) the reform of landholding and (iii) the securing of full employment in agriculture through occupational redistribution of population under the stimulus of industrial development. Secondly, the farmer must get the minimum price which is sought to be maintained. This would require a different type of agricultural marketing and considerable interference with a free market economy. Since effective price stabilization would be impossible without physical controls, at least State-controlled trading, if not direct State trading, will become indispensable. Thirdly, the farmer must not bear the brunt of maintaining stocks. Trade in agricultural produce suffers from chronic instability due to a tendency on the part of all agents in the business chain which connects the primary producer with the ultimate consumer

to shift back the responsibility for maintaining stocks. Apart from the precious metals and certain staple products, such as rubber, sugar and tea, stocks are reduced to the minimum. Stocks are kept at a minimum because prices fluctuate, and the reduction of stocks in itself tends to accentuate fluctuations of prices.[29] Thus as the result of instability of prices the brunt of the burden falls on the farmer to whom the responsibility of maintaining stocks is shifted. Hence unless the farmer is relieved of such responsibility there is little chance of stabilizing his purchasing power. Fourthly, rational crop planning which is essential to the success of any scheme of stabilization of agricultural prices would imply a considerable extension of the system of physical controls operated by the State. The Policy Committee on Agriculture, Forestry and Fisheries (appointed by the Government of India to deal with post-war reconstruction) passed the following resolution on crop planning: 'The production of raw materials should be increased to meet the growing needs of industry as well as the requirements of export, while maintaining a proper balance between food and cash crops.' If this resolution were to be implemented by keeping in view the objective of stabilization of agricultural prices (which the committee must have had in mind) considerable interference with the free market economy would follow as a matter of logical consequence. The State will know through the machinery set up for working the international commodity schemes the exact quota of any agricultural commodity to be exported, and since it is also expected to know the estimated domestic consumption it can plan the acreage in a manner which is conducive to price stability. Similarly if the State knows the import position regarding the quantity and quality of a certain agricultural product to be imported, it can plan the domestic acreage on a rational basis. If it is found that owing to

29. During the inter-war period there was a premium on distant positions, whereas before the last Great War the 'future' position had always been normally below 'spot'. This was due to pessimism in regard to immediate demand and prices during the period of depression. The premium on futures was encouraging traders to buy from hand to mouth and was thus increasing the instability of agricultural prices.

technological progress in agriculture or development of new sources of supply domestic production of any crop has become 'high-cost' production, the State will have to protect domestic production *temporarily* (through a quota or a subsidy) and then direct farmers to shift to alternative crops or occupations.[30] Again, a proper balance between exports and domestic requirements of raw materials would need price control machinery designed to control internal as well as external trade. Stabilization of internal prices when prices are fluctuating cannot succeed if export prices are left uncontrolled and supplies can be freely diverted from the internal to the export market in response to higher prices.[31] Lastly, effective representation of consumers on price stabilization boards and safeguarding the interests of agricultural labourers must be indispensable features of any programme of stabilization of agricultural prices.

30. It must be emphasized that stabilization ought to be aimed at neutralizing short-period fluctuations; but if the level of prices artificially maintained within the country does not correspond with the long-period secular trend there is a danger of the breakdown of control and consequently much more violent fluctuations of prices. Stabilization of prices at an artificially high level in the face of a secular fall of world prices can, of course, be maintained by subsidy at the expense of the community, but its burden may be too disastrous to contemplate.

31. Control of export trade and export prices will also be necessary to stabilize at a reasonable level prices of manufactured consumers' goods (particularly cotton textiles) which will have a big export market in the Far East after the war as the result of the destruction of Japan's industries.

Chapter 5

RECONSTRUCTION OF FOREIGN TRADE: INSTRUMENTALITIES OF TRADE REGULATION

Judging by the trend of economic opinion in India and the enunciation of post-war economic policy as contained in a recent Statement of Government's (of India) industrial policy, India is already committed to comprehensive economic planning on a national scale. The logical consequences of implementing a policy of providing 'a high and stable level of employment', as the Statement puts it, 'of increasing the national wealth by the maximum exploitation of the country's resources', and of 'making the country better prepared for defence', are direct intervention of the State in the market process and State control of the allocation of a very considerable, if not the major, part of the economic resources for production. Direct regulation of the market process by the State will be governed largely by the allocation of productive resources according to plan, which will naturally involve regulation of not only prices and production, but also of saving and investment. But if there is direct regulation of internal trade, regulation of foreign trade is inevitable as a logical step.[1] There must be ways of controlling foreign trade; otherwise the national economic plan is liable to be upset through unforeseen fluctuations in the prices and/or quantities of particular kinds of exports and imports, caused by external factors beyond the control of the planning authorities. The internal price level, the structure of relative prices (for example, of capital goods as compared to

1. The Government of India have, in fact, recognized that 'if any comprehensive scheme of industrial development is undertaken in the post-war period, some form of trade control, particularly on imports, will be found inevitable' (*Second Report on Reconstruction Planning*, p. 23). For one thing, it is not merely comprehensive 'industrial development', but economic development in general which necessitates trade control; and, for another, the control of exports will be no less important than the control of imports as a means to national economic development.

consumers' goods, and of manufactures as compared to agricultural products), and the production plan depending upon them, can be most effectively protected against passing economic disturbances originating in the outside world—there will be plenty of them in the transition period after the war—if *either* foreign trade is dispensed with, *or* if it becomes the monopoly of the State. Since the first alternative is out of the question, it is the second which should appeal to most nations, particularly when the international market process is operating badly and foreign trade is already dominated by monopolistic buying and monopolistic selling through the agency of international cartels. There is little doubt that State trading or State-controlled trading, which has played an important rôle in war-time, will not liquidate itself as soon as the war ends, but will be found to be the only means by which international trade can at all be re-started after the war. After the war the persisting distortion of the price systems in different countries and the continued disharmony between the national price levels will not permit of international trade being conducted on orthodox lines on the basis of price competition in a free market. Hence unorthodox methods of State trading will become indispensable at least till non-discriminatory, competitive methods of trade are open to nations. Nor can we expect international trade to be conducted in terms of a universally acceptable medium of exchange, so that exports, wherever sold, will be paid for by a universally acceptable currency. The primary concern of a country will be to sell exports against those currencies which will be accepted in payment for urgently needed imports. This would require direction of exports by the State as part of public policy.

In this chapter it is proposed to discuss very broadly the technique and instrumentalities of trade regulation which the State must employ in this country consistently with comprehensive economic planning on a national scale and in the light of the abnormal circumstances in which a plan of economic development has to be executed after the war. Our analysis may be divided into three parts, viz., (1) Regulation of foreign trade; (2) Regulation of internal trade; and (3) Monetary regulation. Such a division is meant only for

convenience of analysis; in fact the control measures under the three heads will have to be dovetailed into each other to provide an integrated pattern of economic control.

Regulation of Foreign Trade

First, let us try to form a general idea of the instrumentalities needed for the regulation of imports. Regulation of imports in the light of India's needs and capacities will have to be both *quantitative* and *qualitative.* The total quantity of imports will have to be limited to what India can afford through the liquidation of foreign balances, through the ordinary process of export trade and through importation of foreign capital, if possible, which would create an import surplus. This total would depend, at any rate in the period immediately following the war, upon the manner in which export trade can be directed as part of public policy so as to finance our imports. Within this total, economic policy will require a system of priorities to ensure that imports requisite to maintain the minimum standard of living, or to meet the needs of essential industries as determined by an over-all plan of economic development, should take precedence over the less essential imports. Once essential imports are obtained, there should be a margin for 'free' imports, though the amount of 'free' imports would be seriously limited in the transition period by the amount of foreign exchange which the Reserve Bank of India can afford to release. Given continuous internal expansion and a gradual rise in the standard of living, and provided there is expansion of world trade under the best of conditions, the size of this margin, or the uncontrolled sector of imports will eventually increase; but how far this will happen will depend upon the form which the State control of economic life will take and the relative importance of private enterprise in national economic development.

The technique of trade regulation which easily suggests itself is the war-time import control based on the system of granting import permits or licences according to a scale of priorities which is determined by the distinction between 'essential' and 'non-essential' imports. But war-time import

control, and for that matter economic controls in general, are not adapted to the needs of a peace-time economy. In India the strains of inflation have to be dissipated, and economic catharsis induced to some extent, by first relaxing the war-time economic controls. They must simultaneously be replaced by economic controls which have a wider basis and a different character, require a different apparatus of control, and are adapted to the general trade policy and the requirements of national economic planning. From this point of view tariffs which are a negative, indirect, and, from the standpoint of social requirements, unreliable way of regulating imports, must yield place to the quota system. The flexibility of import quotas in a period of wide economic fluctuations after the war will be a better means of regulating imports than comparatively rigid import duties. The comparative over-valuation of the rupee in relation to sterling and other currencies (owing to the abnormal height of inflation in India) will persist after the war, though not to the same extent as now, because neither drastic price deflation nor any change in the rupee-sterling exchange before the dollar and sterling reach their natural levels after the war, will be desirable in India's economic interests. In such a situation, artificial that it will be, protection of the internal price structure will be as much a matter of concern to domestic industries as protection of their volume of sales. Import quotas 'by removing or weakening the incentive of foreign exporters to engage in price competition' will remove more effectively than ordinary import duties the pressure of foreign competition on domestic prices.[2]

Apart from its merits as a method of protecting the internal price structure and the domestic industries during a a difficult period of economic transition, the quota system will be indispensable in so far as it will have to be assimilated into the system of reciprocal bulk purchase as a means of restarting international trade after the war. A case for reciprocal bulk purchase agreements was made out in

2. Viner, *Trade relations between Free market and Controlled Economies*, (League of Nations) p. 61.

chapter 3. Such agreements will have obvious advantages. They will yield economies of monopolistic buying in an international market dominated by monopoly selling, or at best, by monopolistic competition. They will ensure guaranteed supplies of essential imports at agreed prices, so that the process of reaching planning targets will not be upset by the uncertainty of price and the quantity required to be imported. At the same time, bulk purchasing would be welcome to the seller who receives the assurance of a stable market and to that extent can count upon a national planning of production. When bulk purchase is reciprocal the problem of financing imports also becomes simpler, and at the same time a stable export market for the goods of the purchasing country is guaranteed. But a bulk purchase agreement is nothing but an agreement to permit a guaranteed quota of a particular category or categories of goods to be imported from a certain country. Thus after the absolute quota has been determined according to the requirements of an over-all plan it would be necessary to allocate it by countries (in terms of bulk purchase agreements) and by firms or industries (according to a suitable principle of allocation).

It would be instructive to discuss how import control on the basis of the quota system is likely to operate in the case of the main categories of imports. A principal category of imports which will be assigned a very high priority will be capital goods including plant, machinery, equipment, components and various kinds of intermediate products required for the planned development of welfare. According to the Statement of the Government of India on economic policy in relation to post-war economic development, the State will take a considerable part in economic enterprise. Apart from ordnance factories, public utilities, and railways which together form a considerable proportion of the total industrial enterprise and are already State-owned and State-operated the industrial sector which would either be nationalized (if adequate private capital is not forthcoming) or be subject to State regulation and control, will include basic industries of national importance, such as aircraft, automobiles and tractors, chemicals and dyes, iron and steel, prime movers, transport vehicles, electrical machinery, machine tools and electro-

chemical and non-ferrous metal industries. Bulk generation of electricity would also, 'as far as possible', be a State undertaking. Certain other industries of national importance, such as ship-building and the manufacture of boilers and locomotives, will be run by the State as well as by private capital and enterprise. The State may also take over 'certain industries in which the tax element is much more predominating than the profit element', and of which the salt monopoly is a familiar example. 'Agricultural development will be undertaken almost wholly under the auspices of the State', and 'the capital expenditure will have to be advanced by the State'. The State in India will thus be a large-scale buyer of plant, machinery and equipment for its own economic enterprises. It will also purchase in bulk equipment of various kinds representing items of capital expenditure in connexion with the provision of transport facilities and health services and educational reconstruction. The Government of India will have, therefore, to resort to bulk purchase of capital goods according to plan. They have also promised to 'assist in the procurement of capital goods required by industrialists. They propose to set up an organization in the United Kingdom and the United States of America for this purpose'. The best way to assist private enterprise outside the nationalized sector to buy capital goods is, however, not merely to set up an organization in the United Kingdom or the U.S.A., but to enter into bulk purchase agreements with these and other countries on a reciprocal basis after pooling the requirements of State and private enterprise. It has been decided that in the case of industries which are of importance to India's economic development and which will receive State assistance in various ways including subscription of a share of the capital, and will be subject to considerable State control, assistance might 'in certain cases take the form of bulk Government orders for capital goods which might then be allocated to industrialists on suitable terms'. This procedure should be generalized, and there should be centralized bulk purchase of capital goods on the basis of reciprocal bulk purchase agreements. Allocation of capital goods to industrialists on 'suitable terms' must be made not on the basis of 'first-come-first-served' principle, but to the highest

bidders amongst those industrial firms who have been granted a licence and have, in the opinion of the Licensing Board, financial standing, adequate capital and access to economies of large-scale production.

The same method of regulation may generaly apply to essential imports of consumers' goods which the planning authority may choose to import at any time. In this case, however, the size of the quota will depend upon the domestic production of consumers' goods. Moreover, it must be borne in mind that the quota system based on bulk purchase can operate successfully only in the case of standard articles of consumption. This limitation may not be an insuperable difficulty if the planning authorities permit during the planning period only imports of 'essential' standardized goods. Allocation of the quota will be by countries and by importing firms. Allocation by countries may be in terms of reciprocal bulk purchase agreements, if there are any, the residual unassigned quota being available for any country without any discrimination. Allocation by firms in this case may be on a principle different from what has been suggested in the case of capital goods. Importing firms who had, till the outbreak of the war, trading connexions with exporting firms in various countries, would naturally want to have an allocation of the quota in proportion to the trade handled by each. Wherever the quota system worked before the war the question of a proper allocation of the quota among the importing firms had to be tackled with great difficulty. In the light of past experience in many countries three possible ways of allocating the quota among the importing firms suggest themselves. First, the import licences may be sold to the highest bidders (as suggested in the case of capital goods for new industries) and made freely transferable. Such a procedure may be defended on the ground that after years of rigid import control there are not important vested interests in the different lines of import trade, and importing firms may have to start afresh in most cases and face a post-war situation in which old business connexions and old channels of trade (for example, trade with Germany and Japan) will have disappeared. Besides, such a procedure will avoid possible discrimination in granting import licences

and bring into play competitive forces of a free market economy to the benefit of consumers. A second method of allocation of the quota among the importing firms may be to fix the allotment on the following principles:— (1) that the share of a particular firm must bear the same proportion to the total quota as the trade of that firm bore to the total trade during a representative period before the war; (2) that a certain percentage of the quota must be reserved for the new firms to prevent a freezing of the *status quo;* and (3) that since internal expansion may lead to the expansion of imports, subject to the requirements of the national plan, the additional quota that may be available should be either largely reserved for new firms or distributed *pro rata* among the firms holding importing licences. The second method of allocation will involve the danger of pressure groups within particular trades raising administrative and even political difficulties. There is a third method of allotment of the quota according to which the assignment of the quotas to particular firms may be handled, by agreement, by the exporting countries. As Professor Viner says, this method has been favoured by those countries who have wanted to shift elsewhere the unpleasant burden of allotment of quotas to particular importers and thus avoid 'possible unfavourable political repercussions at home'. But, as he explains, this method has its merits when the export trade is more concentrated and evasion can be more easily controlled by the exporters' organizations. Domestic producers may also welcome this method if the foreign exporters, organized on the basis of getting the maximum prices possible, are allowed to operate the quota.[3] It need hardly be pointed out that the third method of allocation of the quota should be rejected in the case of capital goods the allocation of which must be determined by the planning authorities according to the requirements of the national economic plan, and not by foreign countries exporting capital goods.

There remains the third important category of imports, viz., food and important raw materials which will constitute

3. ibid., pp. 56-57.

'essential imports' after the war. Regulation of these imports should proceed on the same principles as are applicable to other kinds of imports, but it will have special features which have to be noted. After the war importation of food will have a higher priority than any other category of imports in any scheme of post-war economic planning. In India the production target in respect of food has to be aimed at (1) raising the *per capita* consumption according to improved nutritional standards; (2) feeding the additional numbers of the population in the future on the improved scale, (both of which imply an increase in the volume of food production not only overtaking, but also exceeding, the increase of population); (3) reducing India's dependence on external sources of supply; and (4) holding necessary reserves. These long-range objectives cannot be reached on the basis of a subsistence peasant farming and without far-reaching changes in agricultural organization and technique, which will take time. It is, therefore, very probable that for a considerable time after the war, even with the possible rise in per acre productivity and the expansion of acreage, India will be dependent upon substantial imports of primary foodstuffs, *provided* the effective demand for food is not only maintained but shows a desirable rising tendency. But regulation of food imports will have to be carefully devised. Immediately after the war the unsettled conditions of food production in many countries may interfere with India's obtaining her import requirements through the normal process of trade. It will, therefore, be necessary to enter into reciprocal bulk purchase agreements with Burma or other liberated countries of South-East Asia to obtain rice in exchange for raw materials and manufactured products, or with Canada and Australia, if necessary, for imports of wheat. At the same time while food reserves might be built up by means of imports (and this will even otherwise be necessary to stabilize the prices of primary foodgrains) the domestic supplies may have to be carefully husbanded and distributed on the basis of partial rationing. Subsequently a stage will come when the import quota in the case of food may become part of international commodity agreements in

respect of both wheat and rice.[4] Crop planning, so far as cereal crops are concerned, can be placed on a reasonably stable foundation, if India can know on the basis of international control of food production what her quota for rice or wheat may be during a certain period. Moreover, quota restrictions and price agreements designed in the interests of both domestic and foreign producers can contribute to the stabilization of the incomes of food producers who in many countries form the poorest section of the population. But if international stabilization of the prices of foodgrains does not succeed, regulation of imports of primary foodstuffs by means of an import quota will have to form part of a domestic scheme of stabilization of agricultural prices. When a fall of the internal prices of cereals is threatened by cheap imports the quota will have to operate as an instrument for protecting the internal structure of cereal prices. On the other hand, when there is scarcity of internal supplies and a rise of cereal prices the State will have to relax, and, if necessary, remove quota restrictions, besides releasing stocks from the central foodgrain reserve which will be a permanent feature of food administration in this country if food prices are to be stabilized and adequate supplies assured to consumers. The regulation of imports of raw materials does not raise any new principles. As regards agricultural raw materials in respect of which India may be a net exporter (importing certain kinds and exporting others, but exports exceeding imports on the whole) the quota will have to operate as the means of maintaining the price parity or the normal price differential between the domestic variety (for example, short-staple cotton) and the foreign variety imported (for example, long-staple cotton) until agricultural production can be suitably readjusted. On the other hand, in the case of raw materials which are not produced in India in any substantial quantity, or are not produced at all in India, the policy of free imports without any quota restrictions will be the best, unless reciprocal bulk

4. There is no international agreement with regard to rice, but the author thinks that such an agreement would be absolutely necessary for the economic stabilization of the rice economy of monsoon Asia.

purchase agreements have to be concluded, or India is granted a quota under an international commodity agreement (for example, in the case of tin, rubber, camphor, scarce metals, etc.).

The instrumentalities of trade regulation discussed so far are by their very nature such that if they are used State trading or State-controlled trading is likely to become a regular economic institution in this country. State controlled trading is inevitable in so far as cartels, or trading associations, (which should be sponsored by the State in India) are brought under direct public control, so that they can approximate in fact to public international controls or quota agreements for standardized products. As Professor Viner says, a trading agency which has monopoly power will practise monopolistic discrimination in the strictly economic sense to maximize its net gain. It will carry out 'the practice of discriminating monopoly', i.e., instead of buying only in whatever market happened to have the lowest prices, it will buy 'at higher prices in markets with elastic supplies and lower prices in markets with inelastic supplies, and instead of endeavouring to equalize its purchase prices in different markets it will seek to equalize as between the different markets its marginal expenditure per unit'.[5] So far the existence of monopolistic competition has been recognized in the field of home trade. It is necessary to recognize its existence in foreign trade as well. And State trading or State-regulated trading should comprehend and assimilate monopolistic buying and selling in the sphere of international trade conducted by private cartels and trade associations. In fact Professor Viner, who is a staunch advocate of free enterprise, has been constrained to admit that 'the practice of bilateral government monopoly may prove less injurious to the participants than would passive adaptation to the badly operating, monopoly-ridden, tariff-bound processes of the market place.'[6] It is precisely such a realistic attitude to State intervention in foreign trading which will be more

5. ibid., p. 77.
6. ibid., p. 82.

helpful and constructive in India than mere repetition of the slogan of free competitive enterprise.

What should be the nature of the organization which must be set up as an agency of State trading or State-controlled trading? The Government of India have already declared that 'State-owned organizations should be set up at the appropriate time for the purpose of trading with State-trading countries or in commodities produced or manufactured by State-owned enterprises.'[7] If, as is likely at any rate during the transitional period, State trading becomes a predominant feature of international economic relations, State-owned organizations for conducting foreign trade are bound to be set up in India. How far the Government of India will be able to shoulder the big responsibility of State trading not on a limited, but on a comprehensive scale, should that be necessary, is a highly debatable question. But the responsibility cannot in any circumstances be evaded. At the same time the private sector of trade cannot be left uncontrolled and unorganized, and in any case since internal trade controls will have to operate (as will be explained below), control of the private sector of foreign trade will also be necessary to ensure stability of prices, production, employment and income. The State must, therefore, sponsor Trade Boards to deal with imports and exports respectively. So far as import trade is concerned, there should be a Board of Import Trade for handling the import trade as a whole. There should also be bureaus subordinate to the parent body which should deal with different lines of import trade. Naturally private importers elected by their existing organizations, such as chambers of commerce and trades associations, would be represented on the parent body as well as the subordinate bureaus. But there must be effective representation of the State and the consumers on these bodies to guard against the economic feudalism of unrestrained private capitalism. The State must retain wide powers of initiation, supervision and regulation not only for serving public in-

7. *Second Report of the Reconstruction Committee of Council on Reconstruction Planning*, p. 23.

terest in general but also for co-ordinating the private sector of trade with the public sector. To make these bodies 'independent' is merely to secure that their decisions cannot fit into the framework of the national economic policy, while they would be exposed to the pressure of vested interests. It need hardly be emphasized that trade policy should not only be laid down by a minister responsible to the legislature, but should also be administered by him in co-operation with the commercial interests and consumers after taking into account their special needs and difficulties. The machinery of control suggested above which will regulate not only import trade as a whole, but also trade in different lines, will have to be employed for controlling a new form of import trade which has appeared in recent times, viz., import and internal distribution through subsidiaries or branches of companies domiciled abroad, established in India for this purpose. This is a difficult and delicate task which can only be performed with the assistance of the State and not by private trading corporations left to their own devices.

One may ask, what would be the place of tariff protection in the scheme of import regulation outlined above? Since quotas would, on the whole, be a better substitute for tariff protection the latter should eventually be dispensed with. Many countries before the war had a quota system superimposed upon the protective tariff. But it would not be proper to retain both. As already explained, the expansion of the scope of State economic enterprise will enhance the importance of the State as a large-scale consumer. In other countries State trading has a protectionist aspect. As a matter of administrative practice, or, as in the United States, in accordance with statutory requirements, the State in making its purchases gives to domestic sources of supply 'additional substantial preferences with respect to prices.'[8] The Government of India in its Statement of post-war economic policy has announced that 'subject to reasonable safeguards as to quality and price, Government will continue to encourage

8. Viner, *Trade Relations between Free Market and Controlled Economies*, p. 72.

Indian industry by buying its products in preference to others.' How far this policy will afford to Indian industries 'additional substantial preferences with respect to prices' remains to be seen. But the obvious advantage of relying upon large-scale government purchases of the products of domestic industry should not be underestimated. Moreover, various indirect methods of direct assistance and protection for the benefit of Indian industries in certain cases have been proposed by the Government of India. These include making loans, subscribing a share of the capital, providing in suitable cases capital equipment like buildings, services and/or machinery on terms to be settled on the merits of each case, guaranteeing a minimum dividend on capital or undertaking to meet revenue losses for a fixed number of years in special cases, giving financial support to research organizations set up by Industrial Associations, apart from laying the foundation of industrial progress by developing facilities of transport, technical education and scientific and industrial research, and undertaking a survey of mineral resources. When these various forms of State assistance and 'indirect protection' materialize there would be little justification for tariff protection in addition to the quotas. The attitude of the Government of India to tariff policy as revealed in their Statement of post-war economic policy is, however, different from what has been contemplated in this chapter. They have not yet formulated 'a long-term tariff policy and the establishment of permanent machinery for the purpose.' In 1940 they gave an assurance of post-war protection to essential war-time industries. They have, also, recognized that outside the range of these industries 'lie a large number of industries which have helped to sustain the national economy during an exceptionally difficult period.' Such of them as have been 'established on sound lines' have also been promised 'assistance or protection' during the difficult period of transition, and the Government of India have proposed to 'set up machinery without delay for the investigation of the claims of such industries for assistance or protection.'[9] In the mean-

9. It is a matter for satisfaction that the Government of India have decided upon 'the liberalization of the principles governing the

time applications setting out claims to protection have already been invited from the industries concerned. This procedure of selective protection of industries is, as the Government of India puts it, 'a short-term measure.' But it is quite clear that haphazard, selective protection even as an *interim* measure will not be expedient. It is necessary to grant protection to industries according to plan; otherwise the decisions of an 'independent' *ad hoc* Tariff Board or any other body which may be constituted for this purpose, will not fit into the framework of a national economic policy and may be exposed to the pressure of vested industrial interests. Moreover, as the analysis contained in this chapter clearly shows, in the difficult period of transition after the war regulation of import trade will have wider implications, and the quota system of regulation would be more appropriate to the post-war economic needs and conditions of India, than the regulation of imports by tariffs. It remains to be seen, however, whether the Government of India contemplate *merely* a liberalized formula of 'discriminating' tariff protection.

We shall discuss next the instrumentalities needed for the regulation of exports. An increasing number of countries after the war will probably conduct their foreign trade through State or State-sponsored trading corporations. Hence individual exporting firms in India unless they are organized will be at a serious disadvantage in dealing with such national organizations in other countries. The Reconstruction Committee of the Governor-General's Executive Council have, therefore, proposed that 'encouragement should be given to the formation of larger export units.'[10] This policy can be best implemented if an organization parallel to what was suggested above in the case of import trade is set up on the

selection of industries and of the procedure for the initiation and conduct of investigations into claims to protection. The grant of protection would not be confined to existing industries, and investigation about the necessity for granting protection to industries yet to be established would be made'. (*Second Report on Reconstruction Planning*, p. 24).

10. *Second Report on Reconstruction Planning*, p. 23, para 2.

initiative of the State.[11] Since the Government of India have already decided that 'agricultural development will be wholly under the auspices of the State,' and since agricultural exports will form a major part of Indian exports, the Government of India will have to be vested with considerable powers of direction and control over the organization of export trade. As in the case of import trade, there must be a Board of Export Trade (not necessarily a corporation in the legal sense) which may be organized on the basis of export trade as a whole, to which must be attached subordinate bureaus dealing with export trade in specific commodities. Wholesale dealers, exporting firms, co-operatives and consumers, besides the Government as the planning authority, should be represented on the parent body as well as the bureaus.

The machinery of regulation suggested above will perform at least certain definite and important functions which may be briefly explained. In the first place, since India's primary concern after the war will be to sell exports for those currencies which will be accepted in payment for urgently needed imports, or to link up bulk sale with bulk purchases, the direction of exports (as regards their destination) will become part of public policy and a matter of negotiation with other governments, and the Government of India will have to be guided by the experience, co-operation and advice of an export trade organization. In the second place, the co-operation of this body will be necessary for a proper observance of the quota limits which may be allotted to India in respect of certain commodities (either in consequence of international commodity agreements, or otherwise) and for the distribution of the quota amongst the exporting firms. In the third place, this body may very well perform the function of laying down the requirements of grading, standardization and improvement of quality for the guidance

11. On page 10 of the *Second Report on Reconstruction Planning* there is mention of 'organization of internal and external markets, e.g., through an Indian Export Corporation', as one of the various measures which the Government of India may adopt 'to assist and encourage the promotion of private industry'.

of producers and the marketing organization handling the procurement of commodities for export. It may perform the useful function of suggesting the lines on which replacement of raw materials by semi-processed materials is desirable and necessary and the manner in which expansion of trade in particular directions is possible. Close *liaison* between this body and Indian Trade Commissioners abroad will increase the efficiency of both in solving some of the difficult problems which Indian exporters will face after the war with regard to the marketability of some of India's staple exports. Finally, the most important function of this body would be to recommend to the Government of India appropriate measures in the form of quantitative regulation of exports as part and parcel of the policy of maintaining the stability of internal prices. Ensuring adequacy of supplies and maintenance of reasonable prices within the country are not possible if export prices are left uncontrolled and supplies can be diverted from the internal to the export markets. After the war the acute scarcity of primary necessaries like foodgrains and cotton textiles in countries devastated by war in Europe and Asia, will draw off supplies from India in response to higher prices offered and create extreme privation within the country, if exports are left uncontrolled. Hence if internal price control, which ultimately depends upon physical control of supplies, is to succeed as a measure of averting an economic disaster, it would be absolutely necessary to regulate the quantity and rupee prices of exports. Action will have to be taken on the lines of the Cloth and Yarn (Export) Control Order (8 July 1944). This Order has fixed the maximum margins which may be charged by mills and exporters over and above the ex-mill ceiling prices applicable to similar goods in the internal market. This is supplemented by an export duty of 3 per cent. The object of this Order is to impose a price-ceiling on exported goods, ensure a proper quality of such goods, check profiteering in the export market, and, above all, counteract undue diversion of supplies from domestic consumption to external markets. But the more effective method of controlling diversion of supplies from the domestic to the foreign market will be a system of export quotas the size of which should depend upon the volume of

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essential effective demand within the country which the planning authorities may decide to meet. Thus export quotas may serve an important function as part of a plan of stabilizing the internal price level and, particularly, maintaining a proper structure of relative prices.

It would not be out of place to discuss two methods of assisting the export trade which will have to be assimilated into the general scheme of regulation of exports. First, there must be a State-sponsored institution to supply 'export credit.' It is widely known that the Export Credits Department created in Great Britain after the last war performed a valuable function which private financial houses were not able to perform in its entirety. Its services, which will perhaps be expanded after the war, will be available to the great British merchant houses for expanding the British export trade on liberal terms of credit. The Export-Import Bank of the United States of America which has mainly an economic character, although it has taken on a political complexion during the war, will similarly be a powerful instrument of American 'trade drive' after the war, now that the capital of this Bank is reported to have become several times its recent size. The advances made under commitments by the Export-Import Bank are foreign loans held largely by private banks, but they are guaranteed by a government agency. It is high time that India had a financial institution of this type adapted to the needs and requirements of her export trade. In chapter 2 it was illustrated how the lack of organized sales and of export credit facilities cost India a large share of her market for cotton piece-goods in East Africa when Japan concentrated on the capture of this market in the 'thirties. The Japanese (as well as the Dutch) exporters of cotton piece-goods distributed their goods in East Africa through a firm which virtually performed the function of a selling cartel. The importance of such a cartel arose largely from the means it possessed of controlling credit, trading limits and stocks of retailers. On the other hand, in the case of goods shipped from India D.P. terms between Bombay and East Africa prevailed very largely.

The second method of assisting the export trade, which is, of course, of a more controversial character, is the export

of 'social costs', which, in so far as exports would be the means of obtaining urgently needed imports, can be identified with the 'real cost' of planned economic development. The incidence of this burden need not necessarily have a regressive character if the 'real cost' of economic development (as well as its benefit) is equitably distributed amongst the different income-groups by appropriate measures of direct taxation involving compensatory adjustment of the tax burden.

Regulation of Internal Trade

State planning of economic development involves, as already explained, direct interference of the State with the market process which will be governed largely by the allocation according to plan of a very considerable, if not the major, part of the productive resources for production. There are, however, important constitutional difficulties in the way of control of inland trade by the Centre. While 'Trade and commerce within a Province' is specifically mentioned in the Constitution Act and is vested in the Province, 'Inter-Provincial Trade' is not mentioned at all. The power of the Centre to regulate inter-provincial trade is derived by piecing together powers enumerated under different heads in the Federal or concurrent legislative lists. This is a defect of the Indian constitution which must be rectified when the new constitution is framed. But pending the necessary changes in the Government of India Act of 1935, the Centre must be vested with powers to regulate inter-provincial trade according to the requirements of planned economic development. The Government of India have already declared their intention of taking action under Entry No. 34 in the Federal Legislative List according to which the Centre is competent to initiate legislation on 'Development of industries, where development under Federal control is declared by Federal Law to be expedient in the public interest.' When the necessary legislation will have been passed the Government of India will possess direct constitutional authority for shaping the progress of a number of industries of vital importance to the country's economic development. The Government of India have no doubt said that 'it is not necessary at this stage to lay down

more specifically which industries should be controlled by the State and to what extent.' But they have also declared at the same time that industries 'which are at present best left to competitive, capitalist enterprise,' must be subject to such State regulation and control as is necessary 'to see that they are operated for the public benefit after providing a reasonable return on savings and investment.'[13] To implement this policy the State in India will have to possess wide powers to regulate the market process and internal trade movements, which under the Constitution Act it does not specifically possess. Hence it is quite evident that war-time emergency legislation, which has empowered the Government of India to operate the internal trade controls on a national scale, will have to continue in the post-war period after it has been thoroughly reviewed, co-ordinated and consolidated in the light of India's post-war economic planning. But the success of internal trade controls, and of planning in general, would largely depend upon close co-operation between the Centre and the Provinces and States. In fact as the Reconstruction Committee of the Governor-General's Executive Council has put it, one of the limiting factors which must be faced in planning post-war economic development will be 'a spirit of whole-hearted co-operation not only with the Centre, and between Provinces and States, but also between the various communities and commercial interests.'[14] The only way in which this 'limiting factor' can be neutralized is to have a political settlement by which popular ministries at the Centre and in the Provinces would be in a position to initiate and execute a national plan of economic development.

Assuming that the future Government of India will arm itself with adequate powers of regulation of internal trade, it must, first, turn its attention to the removal of barriers to internal trade as a preliminary step. It must lay down certain regulative principles of local taxation which must be observed by local authorities all over India. The rates of local taxation must be low; local taxes must not develop into transit duties;

13. *Second Report on Reconstruction Planning*, p. 9.
14. ibid., page 15.

the staff must be adequately paid, efficiently controlled and removed beyond the influence of the elected representatives of the local bodies; the rate of the terminal tax which should be low must be fixed with the sanction of the Central Government; the basis of the terminal tax should be weight, and not the content of the packages, and it should be levied, as a rule, on incoming traffic alone, the exceptions to be made being determined by the Central Government; the levy of a tax on goods exported by a municipality should not ordinarily be permitted. The Central Board of Revenue must investigate, in close co-operation with Provinces and States, the possibility of making a general sales tax a complete substitute for the octroi or the terminal tax. The Central Government must also have power to arbitrate on questions like discriminatory excise duties, commercial discrimination and restraint on trade resulting directly or indirectly from economic legislation passed by Provinces and States.

These negative measures would be designed to prevent concurrent economic legislation in the Provinces and States from impinging upon trade and distorting its structure, and thereby thwarting the plan of production and commercial distribution of commodities. But what would be the general principles underlying the positive measures which must be adopted with a view to regulating the market process? The number of persons who form the vast marketing organization in India is so large, and their services so various and specialized, that it would be expedient and economical to retain the institution of private trading. Regional development of industry and improvement in the methods and machinery of marketing will reduce the cost of distribution. To the extent that the State will directly regulate production and consumption in certain fields the middlemen who control the marketing machinery will also become harmless. But State regulation of the market process will have to be aimed at the elimination of the anti-social devices, conventions and expedients of private trading. Secondly, State regulation of internal trade should be directed to rationalization of commodity movements. Cross-transport and transportation of staple commodities from a longer distance, when there is a source of supply near at hand, have to be avoided by planning

distribution on the basis of zones. The ultimate solution is, of course, more or less even development of light industry in various regions, each having a wide power base and a marketing base. But even before the final solution is reached, there must be regulated movements of commodities, as in war-time, to avoid at least the strain on the limited facilities of transportation. Finally, regulation of the market process will have to be adapted to the policy of stabilization of agricultural prices. The Reconstruction Committee of the Governor-General's Executive Council have emphasized that 'the stabilization of the price of agricultural commodities at an economic level is essential (by economic level is meant the level of price which will ensure adequate production)'.[15] The general principles which should govern the policy of stabilizing the price level of agricultural products were discussed in Chapter 4. It was explained that to implement this policy the State will have to integrate and assimilate the domestic control of the market process into a co-ordinated control of both exports and imports. We have already described the instrumentalities and the technique of regulation of foreign trade required for carrying out this policy. It is necessary now to indicate the general nature of the domestic counterpart of control measures aimed at the same object. Readers will perhaps recall that this task has also been accomplished in Chapter 4. In the present context we cannot do better than summarize the main conclusions which were reached in Chapter 4, for the sake of gaining a complete perspective. First, regulation of the market process would require price control (based on physical control of supplies and distribution to be successful) aimed at preventing a deterioration of the terms of exchange between agricultural and industrial products. Guaranteeing such a minimum return to the farmer as will 'ensure adequate production' in the post-war period, may require subsidization of agriculture at the expense of the community till agriculture can be modernized through upgrading of labour and technique. Secondly, if the farmer is to get the minimum price which is sought to be maintained, a different type of agricultural marketing, involving con-

15. ibid., p. 39.

siderable interference with a free market economy in the form of State-controlled trading, if not State trading, will become indispensable. Thirdly, since the farmer's purchasing power cannot be stabilized so long as he has to bear the brunt of maintaining stocks, the means must be found for relieving him of this responsibility which he is least able to bear. This merely underlines the importance of setting up a State-owned or State-controlled marketing organization which may be charged with the responsibility of pursuing a particular price policy in relation to agricultural products. Lastly, any system of crop planning (increasing the production of raw materials to meet the growing needs of industry and requirements of exports, while maintaining a proper balance between food and cash crops) can be sustained only by planned regulation of exports and imports and physical control (not merely price control) of the production, procurement and commercial distribution of agricultural products.

The functions of regulating internal trade should devolve upon the Board of Inland Trade, a central body, with subordinate bureaus (as in the case of foreign trade) dealing with trade in specific commodities. The Board and its subordinate bureaus must include representatives of Indian commerce and industry and of consumers, but the ultimate powers of direction, initiative and control must be vested in a minister responsible to the legislature. People talk of the desirability of a 'partnership' between business and government. If this means that ways must be found for greater co-operation between business and government, there can be little disagreement. But we cannot accept the notion of partnership if it carries with it the idea of an alliance between organized business and the government as sovereigns of equal rank. Commerce and industry should be looked to for information and advice with respect to the effects of government policies and specific control measures upon business operations and industry in the private economic sector. But the indivisible economic sovereignty of the government must be accepted, and if this sovereignty is resolutely exercised without fear or favour, the antagonism between business and government is bound to be replaced by a spirit of mutual helpfulness. The experience of government regulation of

industry and trade in war time has not been encouraging from this point of view. But we must not forget that the experience of economic direction and control in various fields at the same time was absolutely a novel one for the Government of India. They had neither a background of business knowledge and experience, nor a set of definite economic objectives to guide them. Enthusiastic public support for their economic policies was lacking, and they had to operate their economic controls under the abnormal conditions created by a 'run-away' inflation and a distorted internal economic structure. But the valuable experience acquired in war-time combined with the absence of the economic stresses and strains of a war economy will enable a new popular government at the Centre to succeed where the Government of India, as at present constituted, failed. The proposed Board of Inland Trade in order to function successfully will have to concern itself with the physical control of the supplies of commodities and services and not merely with price control. One of the tragic lessons of the experience of price control in war-time has been that price control cannot be successful without a proper physical control of supplies. Physical control of supplies can operate directly through control of production and of commercial distribution of supplies in the case of State-owned and State-controlled enterprises; through rationing and pre-emptive purchases, (particularly in the case of food); or indirectly through fixing targets of production and distribution of supplies on the basis of agreement between the planning authority and private industry and trade. If the problem of physical control of supplies is satisfactorily solved, price control will become a much easier problem. Secondly, a Board of Inland Trade can perform its legitimate functions only when there is full co-ordination of policy and action between the Board of Inland Trade and the Railway Board and other transport authorities which may be created to regulate other forms of transport. A unified transportation authority for the whole of India to operate all kinds of transport services will, from the point of view of control of commodity movements, be a far more efficient agency than separate authorities controlling railway transport, road transport or water transport. Finally, the Board of Inland Trade

must work in close co-operation with the Boards of Import Trade and Export Trade; otherwise trade, as a whole, cannot be stabilized, and price control will be exposed to serious strain, and may even suffer breakdown, in abnormal circumstances.

The broad aims of the economic policy to be followed by the proposed Board of Inland Trade have already been defined. The means which may be employed to attain them ought to be a subject of special investigation. But certain specific functions of a basic character which the Board may usefully perform may be mentioned in the form of tentative suggestions. In so far as regulation of internal trade should be directed to the suppression of the restrictionist and monopolistic practices of private traders, in the interests of consumers, it should be seriously considered whether recourse should not be had to suitable marketing legislation. Prohibition of any proviso in the contract that goods shall not be resold except at, or above, a certain price, ban on 'tying contracts', and legislation on the lines of the American Federal Trade Commission Act which is designed to prevent 'unfair competition', will be necessary in India if really free competition in the sphere of private trade is to operate in the interests of consumers. Should such legislation be passed, it would be a function of the Board to see that it is efficiently enforced. There should be a 'price-stop' permitting increases of price only on the basis of increased cost of materials. The charges of merchanting services should be carefully assessed and should not be permitted to increase. In war-time every alert government has tried to prevent the 'snowball' effects of price rises multiplying through various stages of distribution. The familiar method of control is to fix ex-factory ceiling prices, or the landed cost in the case of imported articles, and to specify maximum price margins at the various distributive stages. This procedure, which has also been followed by the Government of India with varying degrees of success in the case of different commodities, should be continued after the war. It should be possible for the proposed Board of Inland Trade to study the defects of the working of the war-time price control machinery and to lay the basis of a sound policy for a peace-time economy. In this connexion the Government

of India, as the planning authority, will have to explore the possibility of a *normative* standard of price control in relation to cost, keeping in view the objective of expanding employment and output. As Professor Joe S. Bain of the University of California has suggested, excess profits in industry should be eliminated, first, by making price equal to average cost in all lines, and, secondly, by reducing average cost to the point where it represents merely the replacement value of services rendered by the assets of the firm. He would allow interest on revalued assets as well as a 'risk premium'; he would reward the innovator by allowing him to retain a part of cost reduction (if the innovation reduces cost) and by giving the producer a subsidy, if innovation is the introduction of a new product. All profits above these are, according to him, excess profits. Professor Bain thinks that if such a form of price control as he suggests is adopted, it will ensure conditions favourable to expansion of employment. 'The ratio of price to average cost is of primary significance to the level of employment, since it affects both the distribution of income between profits and wages and the prices of, and yields on, investment goods. Excess profits in a secular sense will tend continually to skew the distribution of income and to reduce the propensity to consume and the multiplier'.[16] Hence the elimination of excess profits would secure distributive justice in a manner which will stimulate the propensity to consume. At the same time the propensity to invest will not be seriously reduced. An important function of the Board of Inland Trade will be to advise the Boards of Import and Export Trade on the necessary steps to be taken to control both the quantities and prices of exportable goods with a view to preventing supplies from being diverted from domestic consumption to the export markets in such quantities as to create alarming scarcity within the country or upset the stability of the internal economy. Such action would be clearly necessary after the war in the case of primary foodstuffs, sugar, cotton textiles and other necessaries of life. The Board of Inland Trade will also have to obtain necessary legal powers to

16. Joe S. Brown—*The Normative Problem in Industrial Regulation, the American Economic Review Supplement,* March 1943.

regulate the 'Forward Market', so that its operations do not upset the market instead of steadying the fluctuations of prices. If, however, a system of maximum price margins between the distributive stages is introduced, fluctuations of prices brought about by speculative dealings will be confined to a narrow range.

One aspect of State trading or State-controlled trading which should engage prior attention is procurement and distribution of primary foodstuffs. One of the tragic lessons of India's economic travail during the war has been that the nation's food supply should no longer depend upon a system of unco-ordinated subsistence farming. The Reconstruction Committee of the Governor-General's Executive Council are keenly alive to this aspect of the food problem when they say that 'it is now beginning to be realized that India's non-agricultural population, and many of her agricultural labourers, have lived in the past on that small margin which the cultivator may choose to bring to the market to satisfy his needs for cash. There is, therefore, a fundamentally unstable element which governs the food supply of the non-agricultural population, and it is questionable whether it will be safe to rely on a system of unco-ordinated subsistence farming to supply the growing needs of the industrial population'. The possible remedies which they have suggested are (a) some means of adjusting land revenue to prices; (b) payment of land revenue in kind, subject to an option to pay in cash at prices notified from time to time (which will ensure payment of the bulk of land revenue in cash, if suitable prices are fixed, and relief to farmers in a period of falling prices); and (c) organization of co-operative or collective systems of farming which will ensure that an adequate proportion of the harvest will come into the market under all conditions.[17] If the long-range food policy is to ensure an adequate food supply for the growing needs of the industrial population and also to stabilize the price of food at an 'economic level' so as to 'ensure adequate production', the possible remedies suggested by the Reconstruction Committee will hardly meet the requirements of the situation. Payment of land revenue in

17. *Second Report on Reconstruction Planning,* p. 37.

kind with an option to pay cash at prices notified from time to time would certainly reduce the incidence of land revenue in a period of falling prices and afford the farmer much-needed relief. This may be a method of agrarian relief during a period of depression, but by itself it is not a satisfactory method of stabilizing the price of food and ensuring sufficient supplies. In the absence of physical control of supply (not necessarily direct) and of price-fixing on the basis of physical control and movement of supplies, there may be two prices, one ruling in the uncontrolled market and the other fixed by Government at which the farmers would make cash payments in respect of land revenue. If the price fixed by Government is lower than the actual, or the immediately anticipated, ruling price, the 'selected *Mandis* which would pay the equivalent' of the land revenue 'in cash to the revenue staff', would make profits at the expense of the State. On the other hand, the price fixed by the Government cannot be higher than the actual, or the immediately anticipated, ruling price, for otherwise the *Mandis* will not agree to purchase grain delivered by way of payment of land revenue. Moreover, procurement of foodgrains by the method of payment of land revenue in kind, by itself, cannot throw on the market an appreciable quantity. In China where this method has been adopted as one of the alternative means of procurement, the estimated amount of land tax collected in the form of foodgrains in 1943 was only 2·96 per cent of the total production of food. In India the percentage cannot be higher. Secondly, if we assume that the 'gradual' establishment of co-operative or collective farming will ensure an adequate proportion of the harvest being thrown upon the market under all conditions, we forget that (1) at best it is a very long-range solution; (2) the bulk of our food supplies may continue to depend upon subsistence farming; and (3) the necessity of State control of the planning of food production and its distribution in a planned economy cannot be obviated. From whichever angle we look at India's food problem, the only solution which appeals to reason is the policy of Government monopoly procurement of foodgrains, as suggested by the Gregory Committee. Production of food is a vital economic undertaking, a sort of 'key industry' which can no longer be left to the devices of back-

ward subsistence farming. Stabilization of the price of food and the purchasing power of food in terms of other commodities occupies a strategic position in the chain of causation which determines the stability of other prices, and through them, of the economy as a whole. Hence the Government of India, as the planning authority, will have a primary responsibility in the matter of effective control of the price of foodgrains. Government monopoly procurement of foodgrains in its present, or some modified, form will have to be used on a long-term basis as a means of stabilizing the economy of the country. With a proper import control as well as export control, there is no reason why the present form of control, or a modified form of it, from the point of view of supply and marketing of India's agricultural produce, should not continue after the war and be used to maintain the agrarian standard of living above the starvation level till a higher standard of living can be attained through economic development and the development of social services. Instead of fixing statutory maxima the Government of India will have to move in the direction of fixing specific prices for particular foodgrains, and they should be in a position to feel confident of maintaining such prices. Prices need not be maintained at absolutely fixed levels throughout the whole crop year. The prices towards the end of the crop year may be higher than prices soon after the harvest by the cost of carrying stocks. Alternatively uniform prices may be fixed for the whole crop year after allowance is made for the cost of carrying stocks. But the power to maintain pre-determined prices would be the essence of food control. For this purpose Government should procure foodgrain not only in the form of payment of land revenue in kind, but also on the basis of an assessment and acquisition of individual surpluses from small and middle peasants as well as landlords after a careful assessment of the needs of the farmers and their dependents. At the same time the central foodgrain reserve should continue after the war and should be replenished from time to time by imports. Under Government monopoly the activities of the wholesale traders should be confined to acting as Government agents for purposes of handling, storage and transport, and they may be expected to finance the carrying of stocks while

they are in their charge. There is an important aspect of price-fixation under Government monopoly which must be emphasized in this connexion. Food prices can be stabilized with respect to a particular crop year. But wide fluctuations apart, they cannot be maintained at static levels, while other prices are fluctuating. What should be the *norms* which must form the basis of price-fixing ? According to the Japanese system of price control in the case of rice, there was a maximum as determined by the cost of living and a minimum as determined by the cost of cultivation. Price fixing will have to take account of these factors. But when food prices are fixed with an eye to the cost of living or the cost of cultivation, as the case may be, there may be a case for subsidizing either the producers or the consumers, depending upon the rising or the falling trends of food prices. These are difficult problems which will tax the ingenuity and the financial sources of the Government of India. But we cannot afford to shut our eyes to these fundamental problems which are bound to arise when we try to understand the implications of general policies declared by the Government of India.

Monetary Regulation

Monetary regulation, a necessary counterpart of trade regulation, should be governed by an elastic technique which must subserve the following fundamental ends of economic policy :—(1) internal economic expansion, meaning thereby expansion of output, employment and income based on a wide diffusion of welfare in the community; (2) sustaining a structure of non-discriminatory multilateral trade, so that the maintenance of a high and stable level of domestic employment with the help of domestic economic policy and regulation of foreign trade (as defined in the previous sections of this chapter) might be assimilated into, or at least not run counter to, the policy of raising the level of employment and prosperity in the world as a whole through the medium of trade; and (3) preserving equilibrium in the balance of payments. Whether India should remain a member of the International Monetary Fund should be conditional upon whether

as a member she will be reasonably free to adapt her monetary policy to the attainment of these objectives.

India can pursue a policy of internal economic expansion without hampering foreign trade with discriminatory exchange restrictions or quantitative trade regulation designed to preserve equilibrium in the balance of payments, provided that the exchange parity of the rupee is alterable. Suppose intensive economic development in India causes not only an increase in the demand for domestic products and a rise in the level of domestic employment, but also an increase in the demand for foreign imports, which leads to a persistent excess of payments to other nations over receipts from them. To offset this fundamental disequilibrium in her balance of payments, India should be permitted to depreciate the exchange value of the rupee to the necessary extent. In this case since more of rupees would be needed to buy one unit of foreign currency, the prices of imported foreign goods would rise in the domestic market; and, at the same time, since less of foreign money would be needed to buy one rupee, the prices of India's exported goods would be reduced in foreign markets. For these reasons, India would buy less of imported goods, but foreigners would buy more of her exports. In this way the excess of India's international payments over her monetary receipts from other countries would disappear. But India should not try to cure unemployment or stimulate employment by means of exchange depreciation so long as her balance of payments remains in equilibrium, because such a policy would impose economic strain on other nations and thus provoke retaliatory exchange depreciation. In fact if a number of countries resorted to this policy world trade will shrink, as it did in the 'thirties, leading to economic warfare and wide diffusion of unemployment. Hence whether a substantial degree of exchange depreciation is justifiable or not should naturally not depend upon unilateral national decisions but must be decided by an international monetary authority.

The International Monetary Fund provides for a system of variable exchange parities operating within the limits of

international guidance and control. Now that India has become a member of the Fund, at the initial stage the par value of the rupee will have to be expressed 'in terms of gold as a common denominator or in terms of the U.S. dollar of the weight and fineness in effect on 1 July 1944.' But The Fund will allow her to change her exchange rate up to 10 p.c. at her own request; it may permit a further alteration of 10 p.c. after proper discussion, if it is satisfied that such a change was necessary in the interests of India's external equilibrium and was not likely to impose too much strain on her cost price structure.[18] This procedure will, however, be followed only when India suffers from a *serious* and *persistent* external disequilibrium. Before this contingency arises if India has an abnormally large debit balance on current international account which she cannot liquidate in gold or by using her foreign exchange reserves, she would be entitled to buy foreign currency from the Fund within a period of 12 months up to 25 p.c. of her quota and, in the aggregate, up to 125 p.c. of the quota over a series of years.[19] A particular foreign currency in short supply (which is likely to be dollar in the post-war period) will be borrowed, or purchased by

18. There is a danger of a national monetary authority forcing the hands of the International Monetary Fund in sanctioning a particular change of parity planned by a certain country. It can employ its Exchange Equalization Fund for putting a strain on the country's balance of payments and causing a loss in its published monetary reserves, with the object of inducing the International Monetary Fund to sanction a lower exchange parity.

19. The stabilization operations of the International Monetary Fund do not seem to have been defined unambiguously. Thus Section 13 of the Bretton Woods Agreements Act (approved by the President of the United States on 31 July 1945) directs the Governor of the Fund representing the United States to propose an amendment negativing the *possible* official interpretation that the authority of the Fund to use its resources extends beyond current monetary stabilization operations to afford temporary assistance to members in connexion with seasonal, cyclical, and emergency fluctuations in the balance payments of any member for current transactions, so that it has 'authority to use its resources to provide facilities for relief, reconstruction or armaments, or to meet a large or sustained outflow of capital on the part of any member.'

the Fund in exchange for gold, or, if necessary, rationed amongst the member nations. In the last resort general depreciation of currencies in relation to the scarce currency will bring about the necessary increase in its supply, while the threat of general devaluation will always induce a country with scarce currency to take appropriate domestic measures with a view to increasing her purchases and/or reducing her sales abroad. When, however, India is faced with a serious and persistent scarcity of foreign currencies *in general,* exchange depreciation will at once bring about an appreciation of the value of her quota in terms of rupees and also an increase in the supply of foreign currencies through a rise of her exports and a fall of her imports. It should be noted that the only simple criterion which may be used by the International Monetary Fund for sanctioning a change of exchange parity would be whether India has been persistently losing monetary reserves to other countries, or whether she has been persistently receiving monetary reserves at the expense of other countries.[20] For some time to come India's intense demand for capital goods and to some extent for essential consumers' goods, superimposed upon the comparative overvaluation of the rupee in terms of sterling and dollars, will stimulate foreign imports, and, with exports lagging behind, India may be faced with a serious and persistent disequilibrium in her balance of payments, *unless* her monetary reserves are replenished by unfreezing of her sterling and dollar balances and/or movement of foreign capital to India.

It must be clearly recognized that the main objectives of the International Monetary Fund are limited in scope and character. The primary condition of international monetary equilibrium is the uniform valuation of each currency in different markets. In the past stability of exchange rates was maintained through arbitrage operations which overcame local differences in the supply of, and the demand for, each currency. But currency arbitrage can work only if there is

20. Other possible criteria such as differences in the national levels of prices, costs, wages, incomes and employment are very difficult to estimate and apply.

multilateral, non-discriminatory conversion of currencies which presupposes a multilateral trading system. Since the prospects of multilateral trade are not at all clear, trying to set up an international monetary organization (the main object of which should be international exchange stability) before means could be found for restoring a world-wide trading system, is like putting the cart before the horse. In fact the mere possibility of international monetary equilibrium will mostly depend upon the outcome of the proposed world trade conference. In any case since the restoration of a structure of multilateral trade will take time, it is quite clear that the national monetary authority in India should not be lulled into a false sense of security and imagine that a system of multilateral clearing will somehow come into existence as soon as the International Monetary Fund starts operations.

It is possible to define a rational monetary policy for India in the light of these fundamental facts. During the period of transition from war to peace the complete system of war-time exchange control under which all foreign exchange transactions were monopolized by the State, should continue unimpaired but should be adapted to the needs of the peace economy and to possible changes in international economic conditions. Steps should, however, be taken by suitably amending the Reserve Bank of India Act, to vest the currency authorities with the power to operate exchange control through the instrumentality of an Exchange Equalization Fund which should consist of a reserve of gold, rupees, rupee securities as well as currencies which are, or may be, dominant from the point of view of India's trade relations. India's dollar and sterling assets should be partially earmarked to form a nucleus of this Fund. In the difficult period of transition since State control of trade and State trading in particular spheres will be inevitable, exchange control will naturally have to be comprehensive in character and operate in conjunction and conformity with quantitative regulation of exports and imports. Consequently the Exchange Equalization Fund as a pool of gold and currencies will not bear the strain of either abnormal movement of funds or abnormal movement of goods and services. This Fund may easily contain £33 million worth of gold at the old par which the

Reserve Bank of India has in reserve and which may be earmarked as an exchange reserve through suitable amendment of the Reserve Bank of India Act. The principal object of the amendment should, however, be to make the paper currency reserve distinct in law from the Exchange Equalization Fund. As the law stands, the two reserves are merged into one and two separate functions are interlinked, with the unfortunate result that the currency mechanism has operated as an instrument of inflationary war finance through the simple and perfectly legal process of accumulation of sterling securities in London and issue of paper currency in India. Now that India has become a member of the International Monetary Fund there will be economy of exchange reserve. If India agrees to a quota of about £100 millions of which only 25 p.c. has to be paid in gold and the rest in her own currency, she will be entitled to an international credit up to £25 million in a single year and up to £125 millions over a series of years. She will thus be spared the strain of maintaining large foreign exchange reserves to meet possible deficits on current international account. But the extent of such economy should not be exaggerated, because it would obviously depend on the view the International Monetary Fund takes of the adequacy of a nation's foreign exchange reserves of gold and currencies. We must also bear in mind that even when normal trading conditions have been restored and the International Monetary Fund has been operating successfully exchange control would be inevitable. While the national monetary authority would buy and sell foreign exchange in unrestricted quantities at the official rate it would have to restrict, or, if necessary, prohibit the sale and purchase of foreign exchange for certain transactions, such as short-term capital movements and forward exchange transactions involving the sale of currency by persons who speculate on its depreciation. Hence although the International Monetary Fund Agreement aims at the abolition of exchange control as a method of trade regulation, yet it has sanctioned exchange restrictions on undesirable capital movements. If India were to adopt a system of State monopoly of trade, terms of trade in respect of exports and imports will be settled by bargaining, and exchange control

will be entirely redundant. Since this is highly improbable, and the technique of trade regulation suggested in this chapter would permit, within limits, considerable freedom of private trading and of other transactions involving movement of funds, exchange control would naturally have its sphere of usefulness. In practice, however, it would be difficult to impose exchange restrictions on short-term movement of funds and on undesirable forward exchange transactions without interfering with current transactions arising out of trade, for funds can move through the process of trade and, therefore, control of capital transactions cannot be separated from control of current transactions. But India should have no objection to the operations of the Exchange Equalization Fund being supervised by the international monetary organization with the object of ensuring that the Fund is used for smoothing out short-period exchange fluctuations and restricting short-term movement of funds and undesirable forward exchange transactions and allows 'real' causes to affect the long-term trend of foreign exchange.

The principal advantage of operating exchange control through an Exchange Equalization Fund would be that India will preserve her freedom to seek, if necessary, an independent alignment of the rupee with dominant currencies. The factors which forged the fixed link of the rupee with sterling have lost their old force and have not only been profoundly modified by war-time economic developments, but may also be entirely overborne by new and unpredictable factors. In the 'thirties sterling constituted a powerful anchor of stability in a world of dislocated currencies and compared favourably even with the dollar which fluctuated badly and transmitted powerful disturbances all around. It is difficult to imagine that as a debtor nation's currency sterling will now be as strong as it was in the 'thirties. In view of the reversal of the debtor-creditor relation between India and Britain the fixed rupee-sterling exchange can no longer be defended as an essential condition for maintaining India's 'credit' in the foreign capital market and thus ensuring the stability and safety of British investments in India, or for stabilizing the burden of Home Charges in the interests of budgetary equilibrium. It is now also possible to argue that sterling clearing

at a pegged rate of exchange is not crucial for India's foreign trade. During the war more than 55 per cent of India's foreign trade has been diverted to the U.S.A. the British possessions and other countries around the Indian Ocean that are India's immediate neighbours. In chapter 2 it was demonstrated that before the war India's foreign trade had widespread ramifications in spite of the trade-canalizing effects of the system of empire preferences. The future of Indo-British trade relations is obscure, but it would be rash to assume that India's foreign trade will flow back into the old channels. Hence the sterling link should not be allowed to operate as a drag on the possible expansion of India's trade in new directions and to possibly prevent her from obtaining the highest prices for India's exports (which have shown greater diversification during the war) and from importing the required quantities and qualities of capital goods or consumers' goods at favourable prices from competitive sources of supply. The strength and stability of the sterling link in the past, which induced many countries voluntarily to fix their exchange rates in relation to sterling, lay in Britain's strong export position and competitive power and her ability to maintain a fairly wide preferential trading system and to extend the sterling area. Britain's large consuming capacity, progress of technical efficiency in wartime and her determination to wipe out her losses and stand on her feet are her greatest assets in the post-war period. But her capacity to maintain a sterling area on anything but a narrow defensive basis seems to be extremely limited.

Speculation on the desirability of the sterling exchange standard for India becomes, however, pointless when we judge this question in the context of India's membership of the International Monetary Fund, which would require her to start on an initial gold parity. Under the Bretton Woods Agreement the par value of a currency can be changed (with a certain initial latitude) only for correcting persistent external disequilibrium. If the rupee were linked with sterling at a pegged rate as now, any devaluation of sterling dictated by Britain's difficult balance of payments position after the war will mean a corresponding devaluation of the rupee in relation to gold. Such consequential devaluation

will not be permissible, because a change of par value, except perhaps in the case of colonial areas on whose behalf the metropolitan country will ratify the Agreement under Article XX, Section 2 (*g*), will not be justified by the requirements of India's internal and external equilibrium. Similarly there cannot be a bilateral revision of the value of the rupee in relation to sterling alone and not to other currencies. Thus the system of alterable exchange parities recognized at Bretton Woods is clearly inconsistent with a fixed rupee-sterling exchange rate. And any change in the par value of sterling would imply an opposite change in the value of the rupee in relation to sterling. Unless, therefore, the concession in favour of sterling-area arrangements during the transitional period means a *status quo ante* for the rupee, the rupee will become autonomous under the *aegis* of the International Monetary Fund. But this change in the status of the rupee will require the national monetary authority to employ an Exchange Equalization Fund for strengthening the position of the rupee in relation to dominant currencies from time to time.[21] From the point of view of efficient monetary management, however, there must be a change not only in the *composition* of our currency reserves but also in their *location.* When Britain as a great creditor nation was an international monetary centre and a centre of international clearing there was great advantage in locating our currency reserves in London. But they should no longer be *exclusively* located in a country which has now become a debtor country and is likely to face recurrent external disequilibrium. An Exchange Equalization Fund will have to use the financial mechanism of foreign trade to control foreign exchanges by means of a forward exchange market. It will have to buy and sell foreign currencies (within the limited field of arbitrage operations open to it at the end of the war) in order to iron out short-period exchange fluctuations. These operations would require movement of short-term funds which is very likely to be obstructed by the British

21. The power of the Fund to keep the rupee down would be limited by the extent of its rupee resources and its power to keep the rupee up would be limited by the extent of its foreign assets.

exchange control in the interests of the stability of the pound, specially when there is, as is likely, an acute scarcity of important non-sterling currencies. The issues which have emerged from the controversy on the liquidation of India's war-time foreign balances ought to be a sufficient warning to the currency authorities in India.

India's adherence to an international monetary organization should not preclude her from controlling her trading relations with other States in various ways in order to facilitate any type of economic planning which she may choose to adopt. She should be permitted to set up import and export boards (as suggested above) and to plan in advance the foreign trade of the country in the sense of fixing by long-term contracts bulk purchases matched by bulk sales of commodities. But she should be prepared to submit her foreign trade plan for periodic scrutiny by an appropriate international authority who has to be satisfied that the principle of non-discrimination is observed in respect of the movement of trade and prices charged for exported goods. Whether Indian costs and incomes are out of harmony with foreign costs and incomes can also be judged by the International Monetary Fund. But India must insist that any lack of harmony due to 'developmental protection' as a means to economic expansion should not be construed as an infringement of the international commercial code. It should be made clear that internal economic expansion permitted by an international currency organization should be construed to mean stimulation of output and employment not merely by means of monetary expansion, but also by means of direct and indirect subsidization of home industries as part of a plan of developmental protection.

There is one aspect of monetary control and regulation which seems to lie largely outside the sphere of influence of the International Monetary Fund, viz., the concerting of measures necessary for implementing an anti-slump policy. An individual country may, by means of monetary expansion and public works, try to meet or mitigate a general trade depression. But if a number of countries adopt a similar policy which is similarly timed, the task of an individual country becomes easier and the anti-slump policy becomes

more effective in its working. Hence India should be free to join any group of nations who decide to have parallel economic development and a higher level of employment and welfare and also agree to mitigate each other's depressions.

While India should join an international currency organization on the basis of multilateral clearing and on conditions specified above, so long as the wider channels of trade remain blocked during the difficult period of transition from war to peace, India should at least aim at sterling clearing, provided that this does not mean breaking away from the International Monetary Fund. Since the greater part of India's foreign exchange reserves forming the proposed Exchange Equalization Fund will consist of sterling balances, her capacity to operate on the foreign exchange market will obviously depend upon sterling being available for foreign exchange operations. Hence the necessity of a stable rupee-sterling exchange cannot be ignored on a rational estimation of possibilities. Since the introduction of exchange control in London in the autumn of 1939 the definition of the sterling area has become strictly legal in character, and it includes countries to which a transfer of funds could, at least for some purposes, be made freely or with less difficulty than under ordinary exchange control regulations. India's membership of the sterling area does not, therefore, have the same significance as it had before the war. Hence India should seriously consider whether a Trade Treaty between Britain and India as part of a political settlement may not solve the difficult problem of mutual economic adjustment and monetary settlement between the two countries. The minimum conditions on which India may reasonably be expected to remain a member of the Sterling Bloc of her own accord were suggested in Chapter 3. It is necessary in the present context to specify the essential conditions with respect to the adjustment of monetary relations between Britain and India.

First, India must be granted currency autonomy irrespective of whether the International Monetary Fund operates successfully, or whether India is a member of the Fund,

Secondly, India must be free to set up an Exchange Equalization Fund and to operate her exchange control through the use of this Fund.

Thirdly, the Reserve Bank of India and the Bank of England should sell to each other the amounts of the respective currency required for permitted payments by residents of Britain and India. Balances can be offset at any time at the official rate of exchange and any net liability discharged by a sale of gold or dollars, pending the normal functioning of the International Monetary Fund and the restoration of multilateral trade.

Fourthly, in conformity with the Anglo-American Loan Agreement signed on 6 December, 1945, there must be a financial settlement between Britain and India on the following lines:—

(1) Sterling earned by India on current transactions should no longer pile up as part of blocked balances, but should be freely available, for one year from the date of the Anglo-American Loan Agreement for clearing within the sterling area, and in any currency *after* that period. (According to this Agreement the Empire Dollar Pool will be automatically dissolved and multilateral convertibility of sterling ensured, *not later* than one year from the date of the Agreement).

(2) An appreciable part of India's blocked sterling balances should be released as a free balance available, for one year from the date of the Anglo-American Loan Agreement for clearing within the sterling area, and in any currency after that period.

(3) There should be an agreed plan for meeting India's need for dollars in 1946 by (*a*) drawing upon the Reserve Bank of India's account with the Bank of England, which, according to Sir Jeremy Raisman's official statement, has held a part of the dollars accruing from India's exports to the U.S.A. during the war, and which will now be made available, and (*b*) releasing at least a portion of India's share in the Empire Dollar Pool, which should not be beyond Britain's capacity in view of large dollar credits she has received.

(4) The bulk of India's sterling balances should be liquidated in equated annual payments spread over an agreed

number of years with effect from 1951. Sterling thus released should also be multilaterally convertible.

(5) The period of transition extending from 1946 to 1951 should be utilized to establish a wide basis of mutually advantageous trade between Britain and India. Initially India's export surplus in relation to, say, the U.S.A. and Canada may pay for a considerable part of India's import surplus in relation to Britain, assuming that the U.S.A. and Canada will have an export surplus in relation to Britain. Such a largely triangular trade will, under favourable conditions (such as multilateral convertibilitiy of the major currencies and lowering of the tariff wall), gradually form part of a wider pattern of multilateral trade, with the U.S.A. as a terminal point in the various transfer routes. If such a structure of expanding world trade can be erected as early as practicable, India's need for dollars up to 1951 can be met through the International Monetary Fund without unduly straining Britain's dollar reserves. There have been two main difficulties in the way of the multilateral convertibility of sterling. First, as Dr. Hugh Dalton, Chancellor of the Exchequer, stated in the House of Commons while moving a resolution approving the Anglo-American Loan Agreement, restrictions on convertibility of sterling into other currencies could not be relaxed so long as Britain 'still needed to acquire from the sterling area more goods than she could pay for by exports'. Initially the replacement of imports from the sterling area by imports from the U.S.A. will no doubt prevent the piling up of blocked sterling arising out of current transactions. But eventually Britain's present import surplus in relation to the sterling area can be converted into an export surplus if the pattern of triangular, and eventually multilateral, trade contemplated above can be evolved. The second difficulty which makes for blocking of sterling and scarcity of dollars for countries in the position of India is depletion of Britain's gold and dollar reserves. According to Dr. Dalton's statement, Britain began the war with over £600 million in gold and dollars, but her reserves fell to only £3 million in April 1941. Since then the position must have improved, as explained in chapter 3, but a careful 'husbanding of dollar

resources', to use Sir John Anderson's expression, has become a sort of defence mechanism required to ensure Britain's minimum import requirements. There is no doubt that the dollar credits would stabilize and strengthen Britain's foreign exchange reserves and enable her to discharge her responsibility of converting sterling into dollars and other currencies, which India and other countries of the sterling area regard as crucial for their post-war economic development.

Fifthly, there must be an agreement between Britain and India (*a*) to co-operate for the purpose of preventing capital transfers which do not serve direct economic or commercial purposes; (*b*) to mitigate each other's depressions with the collaboration of other members of the sterling area and (*c*) to pursue a parallel anti-slump policy and employment policy.

Finally, the bilateral agreement on the liquidation of sterling balances, which must form part of the Trade Treaty, should provide for such a basis of rupee-sterling exchange rate as will avoid unfavourable exchange fluctuations causing an increase in the real burden of Britain's debt services in relation to India. But such an agreed basis must not prejudice the evolution of a normal parity of exchange for the rupee according to India's price stabilization programme and her programme of economic recovery and development considered in relation to economic trends in other countries.[22]

The most intriguing monetary problem which is inextricably linked up with the problem of India's foreign trade, her economic stability and her economic development is the problem of the exchange parity of the rupee. It seems that the International Monetary Fund will allow India a sufficient margin of discretion to suggest an initial parity which she may deem appropriate. Since fixing an initial exchange parity is a matter of vital importance a good deal will depend on how soon the various factors, both external

22. The Trade Treaty contemplated here should be concluded for a period of three years and should be subject to revision in the light of the increasing opportunities of international economic co-operation in the field of currency, trade, expansion of employment and prevention of slumps.

and internal, which will have a determining influence on the exchange parity of the rupee, will stabilize themselves, or at least how far their relative incidence and economic force can be properly assessed, so that we can have a basis of the external value of the rupee which can be normally sustained without too much strain upon India's costs-prices structure and her currency reserves.

A normal 'free market' economy is characterized by both internal and external equilibrium. To an individual producer 'prices' represent 'income', and to the rest of the community they are 'costs'. Unless prices and costs are in equilibrium, economic life becomes fundamentally unstable. On the other hand, external equilibrium relevant to normal trade relations and normal exchange parity between 'free market' economies implies a harmony between the domestic and the foreign levels of costs and prices. In India the cost and price structure has been distorted by war-time inflation. The general level of prices, the cost of living, wages and incomes and the sectional price levels have been thrown violently out of step. In fact some of the most difficult problems of the transition from war to peace in India relate to stabilization operations in so far as they are directed to the restoration of a costs-prices equilibrium. But India's domestic price policy is tied up with her foreign exchange policy. Without external equilibrium she cannot resume and maintain her trade relations with the rest of the world so as to gear her internal economic expansion to expansion of output and employment in the world as a whole. How the two policies can be dovetailed into each other in a programme of economic recovery is a problem which will tax the highest ingenuity of the monetary authorities. We shall very briefly discuss the purely domestic aspect of monetary stabilization in another context, not because it is less important, but because it is not strictly relevant to the subject-matter of this work. Moreover, we have given priority to the problem of the exchange parity of the rupee because the dimensions of the entire problem of monetary stabilization are broadly indicated by the existing gap between the level of costs and prices in India and that in Britain and the U.S.A. This gap is so glaringly wide that the present official exchange parity

between the rupee and sterling can only be sustained, as in war time, by rigid exchange control. It would be instructive to estimate with a degree of rough approximation what the external value of the rupee is likely to be if foreign exchanges were decontrolled, if trade were reasonably free, and if other things were to remain the same.

Such estimates are usually based on the relative fluctuations of prices and costs in the two countries. The statistics which are used are not strictly comparable. They are based on different methods of compilation; sometimes the base years and the period of time taken into account are different. Owing to lack of economic mobility (both inter-regional and international) specially in a period of economic dislocation and bottlenecks, differences of prices and costs lose a good deal of their economic significance. But in spite of these limitations such estimates as are given below will serve the useful purpose of defining the quantitative limits within which our ideas of the desirable norm of the exchange parity of the rupee should be allowed to crystallize.

First, let us compute the estimates of rupee-sterling parity on the basis of the relative purchasing power of money in the two countries. The wholesale price index for India increased from 100 during the base week ending 19 August 1939, to 246·7 during the week ending 25 November 1944. The wholesale price index (mainly based on the *Monthly Bulletin of the League of Nations*) for the United Kingdom was 112 in the second half of 1939 (January-June=100) and 172 in November 1944 (monthly average). The rupee-sterling parity based on purchasing power parity would, therefore, be $172/112 \times 100/247 \times 18d. =$ *11·1d,* as compared to the pre-war parity of 18d. Since the wholesale price level is governed by prices of commodities which do not enter into international trade, the wholesale price index is not a reliable basis of comparison and can have such significance as we attach to it only on the assumption that the sectional price levels and the level of costs and incomes in various sectors of our economic life are not out of step—an assumption which is unwarrantable in a country such as India whose economy is normally characterized by lack of economic mobility, and is particularly so in the con-

text of war-time inflation and hindrances to the free movement of goods. Hence a comparison on the basis of the relative prices of India's exports and imports would perhaps be a little more significant. Up to 1942 the structure of India's foreign trade had remained unchanged and had been characterized by the predominance of raw and semi-manufactured products in her import trade. During the period 1943-45 the trend was reversed to some extent, and India increasingly became an importer of foodstuffs and raw materials and an exporter of manufactured products. Assuming, therefore, that during the war period as a whole Indian exports belonged to all categories—foodstuffs, raw materials and manufactures—the all-commodities wholesale price index may roughly be taken as a basis. This index increased, from 100 in the week ending 19 August, 1939 to 247 in December 1944. On the other hand, the wholesale index of prices of manufactured products (imported into India) in the United Kingdom rose from 100 in 1939 to 169 in December 1944.[23] The rupee-sterling parity on this basis would, therefore, work out to $169/247 \times 18d = 12 \cdot 2d$, as compared to the pre-war parity of 18d.

On final analysis the fundamental determinant of a country's competitive power in the external market as well as of prices is the structure of incomes and costs in that country. Since the level of costs and incomes must ultimately get adjusted to the cost of living, comparison of the cost of living indices in the two countries gives us the Keynesian consumption standard parity of foreign exchange. Taking August 1939 equal to 100 as the base, the mean of the indices of the cost of living for eight towns (Bombay, Ahmedabad, Sholapur, Jalagaon, Cawnpore, Nagpur, Madras and Lahore) was 274 in about October 1944. On the other hand, in the United Kingdom the index number of cost of living rose from 108 in the second half of 1939 (January-June 1939 equal to 100) to 130 in October 1944. The parity of rupee-sterling exchange as determined by the consumption

23. *London and Cambridge Economic Service* Bulletin I Vol. XXIII. January 1945. p. 5.

standard parity would, therefore, be $130/108 \times 100/274 \times 18d$, or would be *equal to a little less than* 8d.

The shift in the rupee-dollar parity caused by the relative shifts in prices, costs and incomes, as expressed in terms of such statistics as we have been using, reveals a much wider disparity. We can review the position of the rupee in relation to the dollar *indirectly* through the fixed rupee-sterling link or *directly*. As compared to the pre-war rate of $4, the sterling-dollar parity on the basis of wholesale price indices would be $3·2 in view of the fact that the wholesale price index rose from 100 in January-June, 1939 to 136 in the U.S.A. and to 172 in the United Kingdom. The cost of living index (January-June 1939 equal to 100) rose during the same period to 125 in the U.S.A. and to 130 in the United Kingdom. Thus the consumption standard parity works out to $3·84. We must remember that 'the price of dollars rose by 22%, of Canadian dollars by 10%, which (together with other changes in exchange rates) raised average import prices (in the case of the United Kingdom) by 13%, in 1943'.[24] On the basis of the war-time devaluation of the pound the *de facto* sterling-dollar rate has already been $3·12. If the pound were equivalent to about $3 in the near future, on the assumption of the pegged rupee-sterling parity the rupee will have depreciated in terms of dollars by about 25%. When, however we estimate the change in the rupee-dollar parity directly and not *via* sterling, the excess of the official rate of $100 equal to Rs. 332¼ over the rate yielded by a comparison of the wholesale price indices and the cost of living indices is very much more than 25 per cent. While the wholesale price index in the case of India rose from 100 (week ending 19 August 1939) to 246·7 (week ending 25 November 1944), it rose from 103 to 137 in the U.S.A. during the same period (January-June, 1939 equal to 100). Such a relative change in internal prices yields a dollar-rupee rate of about $100 equal to Rs. 617. The cost of living index rose from 100 to 274 between August 1939 and October 1944 in India and from

24. Ibid. *United Kingdom Exports and Imports in War-time* by T. Barna. p. 8.

100 to 125 in the U.S.A. The consumption standard parity works out, therefore, to a rate of about $100 equal to Rs. 728.

A few comments must be made on the reliability of the basic indices which have been used to arrive at these estimates. We have already stressed the limitations of international comparisons based on these indices in normal times. In war-time there are special reasons why they do not give a sufficiently accurate picture of price developments to be regarded as reliable for national or international comparisons. In the case of the United Kingdom and the U.S.A. the wholesale price indices probably reflect the price movements more truly than the cost of living indices. In order to avoid the vicious spiral of a rise of prices and wages, cost of living has been stabilized in these countries partly by freezing of rents and partly through the grant of subsidies to lower the prices of a number of essential goods which enter into the calculation of a cost of living index. Thus in the United Kingdom the rise in the cost of living has been limited to less than one-half of the increase in wholesale prices.[25] Moreover, the cost of living indices in many countries must have become obsolete owing to changes in tastes and needs in war-time. For those income groups whose money income did not increase to the same extent as prices the consequent lowering of the standard of living is reflected in an increased proportion of income devoted to the purchase of food and other bare necessaries of life. In this connexion we must particularly take into account the bearing of rationing on the real cost of living. The usual cost of living index assumes that the goods entering into the index are freely available at the given prices. When, however, this is not the case and expenditure is diverted through rationing, there is a change in the cost of living *additional* to what is indicated by the rise of prices due to the fact that a given expenditure on unrationed goods cannot give the same satisfaction as the same expenditure on rationed goods. Taking this factor into account Mr. Kalecki calculated in 1941 that the total increase in the cost of living in the United Kingdom in May 1941 was around 33 to 35 per

25. *Federal Reserve Bulletin*, September 1945. p. 889.

cent above 1938 as against the official figure of 28 per cent.[26] The difficulty of measuring real changes in the cost of living is also enhanced by the failure of the officially controlled supply system and the development of semi-grey, grey and black markets. In the case of India the indices of wholesale prices and cost of living reflect the changes in real terms too imperfectly indeed. In India there was no attempt at stabilizing the cost of living by means of effective price control or grant of subsidies to cheapen the prices of necessaries of life, and the vicious spiral of rising wages and prices led to a cumulative inflationary process. For large income groups whose money incomes lagged behind prices the lowering of the standard of living was reflected in the increasing proportion of income being devoted to the purchase of food and other bare necessaries of life. The changes in tastes and needs induced by scarcity and high prices must have made the Indian cost of living indices largely obsolete. The reliability of the indices of wholesale prices and cost of living has to be further discounted by the fact that they relate to controlled prices which, owing to the failure of the officially controlled supply system, were much lower than the prices prevailing in the semi-grey, grey and black markets all over the country. Official statistics of wholesale and retail prices show that between 1939 and 1942 retail prices rose less fast than wholesale prices, but after 1942 they rose faster than wholesale prices. But if we take account of the failure of controlled prices to become effective it would seem that retail prices after 1942 bore little relation to wholesale prices, and there was similar distortion in the relation of the real cost of living to wholesale prices. Thus on the whole the indices used as the basis of our estimates do not truly measure the purchasing power of the currencies. But if it were possible to take everything into account in a statistical sense the real purchasing power of the rupee will be found to have suffered a relatively much more serious decline than is indicated by our estimates.

But the rates of exchange suggested by the various alter-

26. N. Kalecki—*Rationing and the Cost of Living Index in the Review of Economic Studies* 1940-41. Vol. VIII.

native estimates should not be taken to mean that India should immediately fix the initial parity at ten or eleven pence to the rupee. These would be true equilibrium rates consistent with the purchasing power of the dominant currencies, like sterling and dollar, *provided* we assume, as already stated, that (1) foreign exchange is decontrolled, (2) world trade is reasonably free and (3) other things remain the same as in war-time. Can these assumptions be fulfilled in the near future? So long as trade is not reasonably free and international clearing is not restored, war-time exchange controls are bound to continue, and, with proper safeguards, the existing official rate of 18d. to the rupee can very well be maintained for some time yet. It is almost certain that Government agencies for fostering trade will be maintained in most countries for quite a long time yet. Moreover, the wide gap between deliveries and counter-deliveries of goods exchanged between nations, which was so evident in war-time, is likely to persist so long as merchant shipping has not organized itself, the channels of trade have not become well-defined through a process of trial and error, and the normal relationship between exports and imports in the case of a country has not established itself. Thus goods are likely to find their counterpart, for a longer time yet, in clearing liabilities or in forms of financing which would not be of the orthodox kind. In these circumstances the existing overvaluation of the rupee will not be for the time being so crucial for India's foreign trade as many people imagine, provided certain obvious precautions are taken on the lines suggested below. But this does not mean that exchange control should counteract the long-period trend of the rupee-sterling or the rupee-dollar rate towards a normal peace-time parity. On the contrary, exchange control will be justified only if it assists the process of evolution of a normal exchange parity by allowing the true long-period trend first to define itself and then to assert itself through the process of trade. But obviously some time must elapse before the long-period trends of prices in India and in Britain and the U.S.A. properly define themselves. The factors which governed war-time prices in these countries were artificial and abnormal. Some of them will disappear, while others will take on a very

different aspect. Hence we have to check up our estimates with reference to probable price developments in these countries before we can judge what the equilibrium rate of the rupee in terms of other currencies is likely to be. This merely underlines the obvious fact that the third assumption stated above will not be fulfilled in the period of transition from war to peace; other things will not remain the same.

It is very necessary to remember that other things will not remain the same, not because war economies will be suddenly decontrolled with the advent of peace (as at the end of the last war), but because national economies will regain their balance and shake off their war-time economic *malaise* mainly through the process of control and regulation. Even a nation like the U.S.A. that believes in the sanctity of free economic enterprise has decided to use wide powers of economic control to restore the peace-time working of a free market economy.[27] Normally it is impossible to be dogmatic about the probable trends of prices (and costs and incomes) in the years to come. While it may seem easier to forecast these trends so far as the objectives of national economic planning are known, the task is really more difficult when we reckon with the imponderable and intractable elements of the post-war economic situation and the maladjustments and uncertainties due to economic forces straining against controls in countries accustomed to the system of free enterprise. On the whole, any such forecast would be hazardous and should be treated with circumspection. Nevertheless this issue cannot be by-passed if we wish to avoid the nemesis which overtook the rupee after the last war.

In Great Britain the advent of peace will most probably lower the prices of many imported commodities. During the war there was a sharp rise in c.i.f. import prices due to a rise in shipping and insurance costs which was again due not only to the rise in the time rates of shipping and insurance, but also to the increase in the time spent in the average journey. By 1940 the shipping and insurance costs were $3\frac{1}{4}$ times the

27. This is like Rousseau's famous paradox of forcing the people to be free.

pre-war level and by 1941 nearly 4 times. There was a fall to $2\frac{1}{2}$ times the pre-war level in 1942 and only a slight increase in 1943. Mr. T. Barna has estimated that the average import prices rose by 11 p.c. in 1943 (as compared to 1938) as the result of the rise in shipping and insurance costs.[28] With a return to peace the burden of the high cost of transport and insurance will be reduced. But against this we must set other facts pointing to a different conclusion. It is not improbable that British import prices (which occupy a strategic position in Britain's price system) will reflect the high prices prevailing in the countries supplying primary products. In many of these countries the domestic price level is already high and can only be brought down by a gradual process. Moreover, most of these countries would want to maintain a reasonably high parity between the prices of primary products and the prices of industrial products. Secondly, the possible reduction in c.i.f. import prices will primarily affect the wholesale trade. It is improbable that the official cost of living index will show a decline. Most probably it will show a rising trend. It has been estimated that without the subsidies granted to keep down the cost of living the index would have stood at 45 on an average in 1943 instead of at 28. According to Professor A. D. Bowley's estimate, in the absence of subsidies the increase in the cost of living index since September 1939 would have been 47% instead of 32%, food prices would have increased by about 24% and all retail prices (including rent) by about 12%.[29] Hence if the subsidies are withdrawn, or at least gradually scaled down, so that stabilization of the cost of living in Britain should reflect the real cost situation as far as possible, cost of living will be actually higher than in war-time. This refers to the general index figure or the average; for particular commodities there may well be a fall from the high prices reached during the war. Thirdly, there would be other influences which would exert an upward pressure on cost of living and prices. During the war in Britain (as well as in many other countries)

28. *London and Cambridge Economic Service, January* 1945.
29. Ibid. July 1945, p. 53.

systems of price control were effectively applied to prevent abnormal shortages and redundant purchasing power from pushing up prices. Thus there has been an increase in private saving on a large scale. Whereas net national income has risen from 100 in 1938 to 188 in 1944, personal saving has steadily increased from 100 to 465 during the same period. The great bulk of this saving is in the hands of the rich. For example, company saving has risen from £259 million in 1935 to £975 million in 1944 (from £170 million to £205 million *net* of taxation). Liquid resources created by the banks during the war amounted in June 1945 to £2633 million excluding personal deposits and advances. If this vast amount of potential purchasing power struggles to become effective without direction and control, prices will soar, there will be wide-spread profiteering and the British economy will be overwhelmed with a runaway inflation. It is certain that this potential danger will be held in check by economic controls during the period of reconversion and readaptation of the war economy. But the consequence of the pressure of immobilized purchasing power will be that although the cost of production in many lines will remain unchanged, yet the greater supplies will not at least depress prices; rather an increasing volume of goods will find its counterpart in the purchasing power already in the hands of the public. But it is assumed here that the wheels of industry will be kept turning by the replacement of huge government expenditure by new peace-time government spending and by private expenditure. A good deal will depend on the success which may attend the policy to be pursued in the field of capital investment in relation to the maintenance of spending power and full employment. As the *Financial News* (28 April 1945) pointed out, allowing for the rise of prices, 'by using for capital replacement about half of its war-time allocations to free reserves, industry as a whole should be in a position to restore its plant to the pre-war level'. At the same time one must take into account the increase of 25 per cent in hourly output since 1938. This large industrial potential of Britain can, however, be harnessed to meeting the needs of a peace-time economy provided that the Labour Government succeeds in solving the problem of resettlement, in securing priority

needs first (through the National Investment Board), in maintaining a low rate of interest (through effective control of investment) and in expanding the export trade through the strategy of balanced growth of world trade and employment and particularly through co-operation to raise productive power in the backward countries. On the whole, however, it would seem that the present level of cost of living in Britain is not only not likely to fall, but may also show a rising trend, and that a fall of prices will be firmly resisted, because it would not only have a deadening effect upon enterprise, but would also materially increase the burden of her public debt inherited from the two wars and newly incurred under the Anglo-American Loan Agreement. It is very probable that prices in Britain will actually show an upward trend, although an inflationary soaring of prices will be avoided at all costs.

When we try to judge the probable trend of costs and prices in the U.S.A. we are confronted by an almost similar economic set-up on a magnified scale. The big drop in government expenditure will leave a big hiatus to be filled by private expenditure. Government expenditure will be large for some time by any pre-war standards. Expenditure on account of liquidation of war effort on a global scale, maintenance of occupation forces in foreign territories, construction of military installations for security reasons and increasing social security benefits (provided by State and local governments) will still absorb a good deal of the nation's real resources. But the price level in the U.S.A. will depend very largely on private expenditure decisions. Inventories of most goods in commercial channels will have to be built up, and private business decisions to spend more on plant, equipment and materials will keep up the level of demand for capital goods and intermediate products. An important element of uncertainty in the economic situation is how far the U.S.A. government will be able to mitigate the inflationary shock which immobilized purchasing power in the hands of the public is expected to produce. The vast mass of potential consumer demand which has grown during the war is a tribute to the technical efficiency and adaptability of the American economy. It appears from official sources that agricultural output per worker increased by 34% since 1939,

and average crop yields per acre harvested increased by 16% during the same period. The result was that in spite of enormous amounts of food being diverted for military and Lend-lease shipments, civilian food consumption in most groups of foodstuffs was above the 1935-39 average. Thus the cost of living was maintained at a low level, and severe restrictions on consumption only affected categories of goods the cost of which did not form a substantial proportion of the consumer's budget. In view of the limited choice of goods available there was, however, a growing mass of redundant purchasing power which took the form of savings. In 1944 net savings accounted for as much as 29 p.c. of the disposable net income of individuals (i.e. income after tax deductions), as compared to 9-10 p.c. during the inter-war period. Such a considerably higher percentage of savings cannot be the consequence of an increase in the genuine 'propensity to save', and so is bound to exert an inflationary pressure on prices if it is left without direction or control. This may not be true of war bonds and time deposits which are likely to be a source of economic security or a means of financing purchases of an investment type. But this is certainly true of most of the savings which have been indirectly created by the expansion of bank credit and represent liquid funds. The potential danger of inflation can be held in check, among other means, by restriction on consumer credit and administrative price control. But the effectiveness of these measures would be reduced by the disappearance of patriotic and other non-recurrent motives for keeping down the propensity to consume. The main factors of uncertainty during the phase of reconversion relate also to the supply side. During the period of readaptation of equipment and resettlement of workers supply is bound to reveal serious bottlenecks. For sometime there will be shortages of products such as lumber, brick, fats and oils, sugar, cotton textiles, worsted fabrics, tin, lead, crude rubber, pulp and paper and coal. The domestic output of most of these products was curtailed due to shortage of equipment and labour. Even if shortage of equipment can be made good, the problem of shortage of labour will persist in some of these industries, for resettlement of workers would be complicated by lower wage scales in these industries, as compared to war

facilities for the production of low-priced categories of goods essential to the fulfilment of the stabilization programme.

Our brief survey of possible economic trends in Britain and the U.S.A. clearly shows that during the period immediately ahead there is little possibility of the cost of living and prices declining in these countries; there is rather a probability of their showing an upward trend. Taking a longer view, however, one feels that if all goes well according to plan in the period of transition from war to peace (particularly if the problems of wages and resettlement of workers are satisfactorily solved) the increased economic potential of these two countries may easily culminate in economic contraction and deflation of costs and prices unless there is a balanced growth of world trade based on co-ordinated economic development in various parts of the world. It is quite clear that unless there is a striking rise in the standard of living in the U.S.A. the potential demand in this country will fall far short of her productive capacity.[30] To sustain her productive capacity she must, therefore, find an outlet for her products in external markets. Paradoxically enough even lend-lease, grants-in-aid, relief shipments and reconstruction and stabilization loans may help to keep the wheels of American industry turning, and this method may be cheaper than financing extensive public works programmes and facing a drastic alteration in the internal distribution of wealth. By working for the restoration of multilateral trade (if necessary, by loans which could easily be generous), the U.S.A., therefore, helps herself and also the rest of the world. Hence if a system of expanding multilateral trade which sustains world employment at a high level cannot be restored an economic depression emanating from the U.S.A. may once more spread like wildfire with far more disastrous consequences than were witnessed in the 'thirtees.

One need not be unnecessarily scared by these dangers. One step is perhaps enough for us. In the immediate and clearly foreseeable future the costs- prices equilibrium in both Britain and the U.S.A. will not be disturbed, and prices and

30. Mr. Morris Livingston says in an article, 'Forecasting Post-war Demand', published in the *Econometrica* (January 1945): 'A capacity national output can only be achieved in terms of a very large

costs in the former will not be very much out of line with prices and costs in the latter. It is very likely that a co-ordinated currency policy will be pursued by the two countries.[31] A sterling-dollar rate which the relative cost price structure can sustain will soon establish itself. Since 30 September 1945 the dollar rate $4·02½—4·03½ has ceased to be guaranteed. The Bank of England has been buying all forward dollars offered to them without any question, but has been selling dollars forward only where British banks are able to explain the nature of the underlying commercial transaction and to satisfy the Bank of England that it has not already been covered elsewhere.[32] It is probable that the initial parity of the pound to be declared by Britain at the time of her entry into the International Monetary Fund organization will be £1=$4·02½ as a tentative rate which may, without any difficulty, be lowered subsequently to £1=$3·63—a rate which nearly corresponds to the war-time *de facto* rate—if circumstances justify such a revision. It should also be noted that in 1944 wholesale prices in Britain and in the U.S.A. still stood, on a gold basis, about 5 to 15 per cent below the pre-war (1913-14) level (and the same was true as regards the cost of living). Since the real cost of production of gold has declined there is no reason why the price level, prevailing in these two countries now, or likely to prevail in the coming years, should be out of keeping with the current value or output of gold, provided that no serious mistakes are made in fixing the exchange parity or in credit policies.[33] This is an additional reason why an appropriate sterling-dollar parity will be an important factor of international currency stabilization which is sought to be attained through the International Monetary Fund and which

improvement in the American standard of living. It means per capita income and expenditures roughly one-third larger than in 1940 measured in constant prices'.

31. The financial link-up between the economies of the two countries as the result of the U.S.A. loan will also lead to co-ordinated economic recovery programmes under favourable conditions.

32. *Bankers' Magazine*, September 1945, p. 185.

33. *Report of the Bank for International Settlements* published in *Federal Reserve Bulletin*, September 1945, p. 894.

is really based on the restoration of a new system of gold standard answering the needs of our time.[34]

It is obvious that the initial exchange parity of the rupee as an equilibrium rate which has a chance of being sustained without intolerable adjustments has to be determined in the light of the probable trend of the sterling-dollar exchange. But since India's foreign exchange policy will obviously depend on her policy of stabilization of costs and prices, the future of the rupee will very largely depend upon the clearness of the objectives of internal economic stabilization and a national determination to build up a self-sustaining and balanced economy. India has to face the same fundamental economic problems of transition from war to peace as Great Britain or the U.S.A., problems like the big drop in Government expenditure leaving a hiatus to be filled by private expenditure and new government spending, resettlement of labour, reconversion and re-equipment of industry, inflationary pressure of immobilized purchasing power and direction and control of peace-time production. But she has to tackle special problems which make the difficulties of post-war economic reconstruction more formidable. These difficulties mainly spring from the hectic inflationary tempo of India's war economy. In India war-time inflation, as already stated, has been an instrument by which *real* resources were extorted from a backward, low-level economy unprepared for meeting the unprecedented needs of war. Our economy was geared to a process of cumulative expansion which was more deceptive than real. Scarcities and bottlenecks raised prices of factors of production to abnormal levels and created a vicious spiral of a cumulative rise of wage costs and prices. This general tendency combined with the failure of the system of distribution and administrative price controls not only disturbed the costs-prices equilibrium, but also the relationship between the sectional price levels. In India stabilization of costs and prices should not, therefore, begin, as in Britain and the U.S.A.,

34. The significance of the American loan to be granted to Britain lies in the fact that the loan is expected to safeguard the stabilization of the dollar-sterling rate.

by stabilizing them at the present level, (by preventing either deflation or inflation), but by not only keeping down the inflationary pressure of immobilized purchasing power, but also removing, by a process of controlled deflation, the distortion of the structure of costs and prices. A full discussion of the co-ordination of measures designed to implement such a policy is beyond the scope of this work. We may briefly touch upon the main principles and objectives of this policy.

In India paper currency expanded between 1939 and 1945 by 500 p.c., while according to official statistics prices rose by about 250 p.c. to 300 p.c. and wages by about 180 to 220 p.c. during the same period. Even making allowance for a wide margin of error in the statistics of wages and prices, the expansion of note issue in India (as in most European countries) has been appreciably greater than the rise in prices, and thus there has been no increase in the rate of turnover of currency (except in periods when public confidence was deeply shaken). On the contrary, currency has been hoarded for reasons of liquidity and for evading war-time taxation, and the turnover of deposits has also been slowed down. The large gap between the paper currency issued and prices and wages is a measure of immobilized purchasing power and of potential danger of inflation arising from an increase in the velocity of turnover of currency irrespective of any fresh issue of paper currency during the period of transition from war to peace. It is a fallacy to think that the present volume of currency can sustain the existing level of prices, incomes and employment. As the amount of 'real' resources available for production is limited, and as the volume of employment provided cannot sustain the present level of incomes, the existing volume of currency cannot but be a source of cumulative disequilibrium, if things are left to the free working of economic forces. It is not difficult to imagine the sequence of events on such a hypothesis. There will be an initial period of inflationary boom, while the hitherto immobilized purchasing power is seeking to translate itself into effective demand. By the time that the process of dishoarding is checked by falling incomes much of the dishoarded money will have found its way into the hands of businessmen through the process of investment and purchase

of consumers' goods. As the depression begins, however, this money will not be absorbed in income and industrial circulation, but will flow into banks and accumulate as idle balances. In so far, however, as the immobilized purchasing power in the hands of the richer section of the community is translated into effective demand for luxury goods, there will be increasing employment and incomes in industries producing such goods. But even then in so far as this purchasing power stimulates the demand for imported goods there will be an increase of foreign employment at the expense of home employment, while at the same time there may be extreme pressure on the rupee-sterling exchange. On the whole, the accumulation of idle balances and the diminished demand for money will be but symptoms of an intense economic depression. In India it will be necessary to forestall these disastrous developments with utmost determination. Fortunately the 'propensity to consume' has been kept down not merely by administrative price control and rationing, but also by the feeling that peace is yet to come and by a general sense of economic insecurity. But the testing time will be the period when the rigidity of economic controls is relaxed, the 'propensity to consume' is quickened and business 'expectation' becomes more buoyant. Hence it is necessary to adopt measures directed to stabilization of costs and prices before it is too late. Since the price and income structure in India has not adjusted itself to the increased quantity of money, there is a *prima facie* case for a lowering of the price level through a process of controlled deflation. The potential inflationary tendencies should be held in check by control over prices, exports and imports, materials, facilities, and even, if necessary, over priorities in respect of movement and transportation. The surplus notes should at the same time be withdrawn from circulation and surplus funds in general absorbed. It may even be necessary to take severe measures to restrict the note circulation and to control the utilization of bank balances. But deflation can be a controlled one only when measures are taken to control wages and salaries so as to restore equilibrium between prices and costs. There should be a scaling down of wages, unless existing or even higher wages are justified, on enquiry, by (a) the necessity

of correcting gross inequities or maladjustments which would interfere with the effective transition to a peace-time economy, (b) the high cost of living, and (c) 'upgrading' of labour. The increasing burden of debt resulting from deflation should be transferred, by compensatory adjustment of the tax burden, to those classes who have benefited by war-time inflation. It is likely that with proper control the abnormal factors of war-time prices, such as hoarding, bottlenecks in transport and distribution, failure of domestic supplies in the face of abnormal war demand and rigid restrictions on imports, will disappear and a downward pressure on prices will be generated. What is suggested here is the restoration of a *largely* self-sustaining economic system based on the present constellation of our 'real' resources. We are not suggesting drastic deflation on a large scale to restore the pre-war price level or the corresponding equilibrium rate of the rupee. The rupee may have to step down from its artificial eminence. But before it is possible to determine the equilibrium rate of exchange the level of costs and prices in India will have to fall by means of controlled deflation while costs and prices in Britain and the U.S.A. are perhaps rising somewhat during the period of transition, so that eventually a balance between the cost and price structure in India and that in the other two countries is not beyond the range of possibility. According to the *Annual Report of the Bank for International Settlements* (for the year ending 31 March 1944) 'it seems on the whole unlikely that, when the war is over, prices on world markets will return to the 1939 level; they may settle down at perhaps 40 or 50 per cent above that level.' The wholesale price index in India being 126 in 1939 (August 1931 equal to 100) roughly an index of 189 may seem to be an objective which the currency authorities may set before itself. But intrinsically the index should be higher in view of the fact that agricultural prices in India had been at an unremunerative level after the trade recession of 1937 even up to 1939. In fact the Famine Enquiry Commission has laid down a target of stabilization of agricultural prices at a level between 180 and 240. If we take into account the unremunerative character of agricultural prices before the war and the necessity of raising the prices of agricultural products in terms of

industrial products in order to sustain the purchasing power of the rural masses and thus to stimulate agricultural development, fixing such a target as is suggested by the Famine Commission does not seem to be overstepping the limits of safety. Obviously the index of prices of industrial products will have to be lower (depending upon the relationship desired to be maintained between agricultural and industrial prices) so as to yield an overall average in the neighbourhood of 200.[35] It is dangerous to be positive about the planned trends of prices. In a well-knit economy characterized by a high degree of economic mobility stabilization of costs and prices would involve physical control of output, besides measures such as control of investment, control of the rate of interest, control of the volume of currency, etc. In India the difficulties to be encountered by the State in operating the necessary economic controls are formidable indeed. We lack a well-knit economy characterized by a sufficiently high degree of economic mobility. The monetary and financial levers of control cannot also act so automatically as one would wish. But still a determined national effort based on the co-operation of labour, capital and consumers can attain the objective of stabilization of costs and prices.

One important point, however, must be emphasized to guard against possible misunderstanding. Our advocacy of controlled deflation is motivated by the primary necessity of curing the *malaise* of inflation. If in the process of recovery of the normal balance of a largely self-sustaining economy the cost and price struc-

35. The problem of a proper parity between agricultural and industrial prices presents considerable difficulties. Without entering into the fruitless controversy that agricultural, and not industrial, prices occupy a strategic position in the price system, one feels that so far as reduction of industrial costs depends on the reduction of agricultural prices there must be an orderly fall in both sets of prices, and, if there is proper control of cost of living and wages, the relative position of either industry or agriculture need not be undermined by a marked shift in relative prices. According to the Economic Adviser's index, prices of manufactured goods dropped from 257 in January 1945 to 239 in May. Nobody can contemplate with equanimity an unplanned fall of industrial prices. But it does not follow that industrial prices should be maintained at the expense of wages or agricultural prices.

ture in India achieves harmony with that in Britain and the U.S.A. it will be a fortuitous coincidence which will enable us to avoid any devaluation of the rupee. But there can be no question of choice of deflation as a currency policy in preference to devaluation. As already stated, the rupee may have to step down from its artificial eminence. What is advocated is that we must be in no immediate hurry to devaluate it before the real equilibrium rate of the rupee in terms of the pound or the dollar evolves itself.[36] The primary need is to avoid the currency debacle of 1920 by first stabilizing the level of costs and incomes and then fixing such an initial parity of the rupee-sterling exchange as will not impose a strain on our cost and price structure and our foreign exchange reserves.

In this context it is necessary to invite the attention of the reader to a fundamental dilemma of expansionist economic planning which India has already accepted as an immediate objective. So long as the process of contracting the volume of purchasing power incidental to a policy of controlled deflation is going on, it would be absolutely contradictory to follow a policy of extensive public works designed to maintain a high level of employment, because the diffusion of fresh purchasing power would delay economic recovery instead of stimulating it. In France the economic situation actually deteriorated in the 'thirties as the result of the Government policy of internal economic expansion, so long as the French franc remained overvalued. Similarly so long as the rupee remains overvalued in terms of the dollar and the pound there is a risk of infusion of fresh purchasing power upsetting the apple-cart of planned economic development, and actually making matters worse. This consideration should have a sobering influence on the inflation-minded enthusiasts of economic planning in this country.

36. In a world of controlled economies even a rough approximation to the so-called equilibrium rate may be quite satisfactory for all practical purposes.

While, however, the process of readjustment of the cost and price structure is well under way, the immediate problem which India will have to face is that of the relative overvaluation of the rupee if, as we have argued, the present official rate of the rupee-sterling exchange is maintained for some time yet. First, there is a clear danger of flight of capital and transfer of short-term funds to take advantage of the overvalued rupee, if exchange control is relaxed. Secondly, assuming that the import controls are also relaxed, since the imports will be artificially stimulated and exports correspondingly discouraged there will be a danger of a passive balance of accounts leading to worsening of the terms of trade and weakening of Indian exchange.[37] This again will strengthen the tendency to transfer of short-term 'hot money' out of a safety motive, if not out of a speculative motive. Hence it would be clearly necessary to counteract both the passive balance of accounts and flight of capital by means of exchange control and state regulation and control of foreign trade. In actual practice both kinds of control will have to be assimilated into a co-ordinated policy. Exchange control alone would not be enough to counteract flight of capital. Exporters may use foreign money for investment and not for getting home currency through the process of trade. Importers obtaining foreign currency may use it for foreign investment or resell it to foreigners who want to get their capital repatriated. Traders may quote inflated prices of imports or low prices of exports to smuggle out capital. Trade regulation and control will, therefore, be necessary to ensure the real success of exchange control operating with the limited object of preventing export of capital.

Fortunately in the difficult period of transition from war to peace the dangers that we have visualized may not be so overwhelming as they seem. Unblocking of the channels of world trade and restoration of comparative freedom of foreign exchange dealings will be delayed so long as the International

37. Released purchasing power impinging upon the limited supply of imported goods will inflate import prices and may easily operate as an inflationary impulse unless the situation is properly controlled.

Monetary Fund is not working smoothly and successfully, shortage of merchant shipping does not disappear, and the settled channels of trade have not been discovered by an initial process of experimentation and trial and error. In the meantime the world market will be a sellers' market, and international trade will have to be started on the basis of reciprocal bulk purchase agreements. Under these conditions, and specially when a number of controlled economies are readjusting their trade relations and their internal economic structures, the overvalued exchange rate of the rupee may not at all be decisive and crucial. But one should not ignore the inherent restrictive effect of the overvalued rupee upon India's export trade. The State will have to be prepared for granting a subsidy to agriculture, if it is necessary not only as part of the programme of stabilization of agricultural prices, but also as a means to restoring equilibruim in India's balance of accounts. Similarly import controls must be used with the same object in view, and, if necessary, may have to be supplemented by exchange rationing.

But there is one serious difficulty which is likely to beset India's import trade. When there is a substantial gap between prices in India and prices in countries from which our essential imports will be derived, in the absence of normal trading conditions, normal clearing and normal supply of shipping, movement of foreign imports will not be sufficiently large to appreciably reduce the difference between their prices in the countries of origin and their prices in India. An element of windfall profit, if not profiteering, will thus enter into the price quotations for imported goods, and an attempt will be successfully made by foreign firms to take advantage of the relatively high level of Indian prices. Such a policy will yield high margins of profit if the market is very largely a sellers' market (for example, in the case of capital goods) and if foreign trading organizations quote prices on the basis of a tacit price agreement amongst the exporting firms of a country. We have had clear experience of such a phenomenon during the war. As Mr. T. Barna states, in five years (1938 to 1943) British export prices rose by 71 to 82%. Up to 1941 export prices rose together with (perhaps somewhat

behind) the relevant wholesale prices. After 1942 the rise in export prices exceeded the rise in wholesale prices. In view of the different content of the two indexes it is difficult, however, to say how far the shortage of British exports was exploited by charging excessive prices. Mr. Barna has further shown that up to Pearl Harbour the United States wholesale prices and export prices moved together, but after Pearl Harbour the rise in export prices was steeper and Britain's terms of trade deteriorated. 'In the five years United States wholesale prices rose by 31 p.c., export prices by 51 p.c.—in terms of sterling, 84 p.c.'[38] A more conclusive example of windfall profit is provided by the sale of gold by the Reserve Bank of India on behalf of His Majesty's Government and the Government of the United States, to the extent of £20 million (according the estimate of the *Economist*) between 17 August 1943 and the end of February 1944. In 1940 South Africa had entered into an agreement with Britain to sell gold to the Bank of England at £8-8s.-0d. an ounce for the duration of the war. But gold was sold in India at a profit of almost one hundred per cent by taking advantage of the gold hunger of the population which showed no signs of appeasement. The danger of inflated import prices based on windfall profits, if not profiteering, can only be minimized by means of price control at the export end as well as at the wholesale and retail stages in India. But price control at the export end can only be a matter for negotiation and agreement between the trading countries. India should, therefore, try by negotiation to safeguard herself against a sharp deterioration in her terms of trade, so long as the relative overvaluation of the rupee is not corrected and normal trading conditions are not restored.

38. *United Kingdom Exports and Imports in War-time* by T. Barna, *London and Cambridge Economic Service, January* 1945, pp. 8-9.

POSTSCRIPT

Proposals for Expansion of World Trade and Employment.

The proposals for expansion of world trade and employment which recently emanated from the United States of America seek to project into the international sphere the pattern of liberal principles of trade and economic relations, such as economic co-operation, non-discrimination in economic relations between States, removal of trade barriers and discriminations, and expansion of multilateral trade. Had they been vague moral generalities which could be accepted with mental reservations, as similar statements of policy actually were after the last war, and which could at least be viewed as a pattern of broad strategy within which the short-period tactics of national trade policies should be free to develop, one need not have taken them seriously enough. But these proposals deserve particular attention, for they are backed by cold economic realism. They seek to translate moral generalities into concrete terms of an international commercial code. Proposals of this character are warranted by, and are the logical consequences of, commitments regarding liberal trade and financial policies made by Great Britain and many other nations under clause VII of the Master Lease-Lend Agreements, and by Great Britain under the Anglo-American Loan Agreement. Without them the Bretton Woods scheme would be a meaningless symbol. The document embodying these proposals recognizes this when it says that 'co-operative action with regard to trade and employment is indispensable to the success of such other measures as those dealing with monetary and exchange stability and the flow of investment capital. Multilateral system of payments in respect of current transactions or free convertibility of currencies presupposes a multilateral trading system. Left to herself Great Britain would not have accepted non-discriminatory, multilateral trade. Opinion was also hardening there against the Bretton Woods currency system which, although more elastic than the gold standard of 1925-31, seeks to restore gold standard 'at a much earlier stage and in a much more tumultuous world.' But the Gordian knot was cut when

the American loan agreement had to be rushed through the Parliament. The loan implied the prior ratification of the Final Act of the Bretton Woods Conference. Some of the conditions necessary for the restoration of non-discriminatory multilateral trade, such as the early dissolution of the sterling area dollar pool, abolition of restrictions on payments and transfer for current transactions except in special circumstances, and non-discriminatory treatment of American imports when imposition or maintenance of quantitative import restrictions are necessary, are set forth in the Final Act as well as in the Financial Agreement. Such fundamental conditions are, therefore, of an absolute character, and derogations from them would not be easy. The proposals for world trade and employment which are merely an implementation of the liberal trade and financial policies are thus bound to be supported by Great Britain at the World Trade Conference, although they have been accepted by her with a poor grace under compelling circumstances. Of the set of interconnected agreements—the loan agreement, the Bretton Woods agreement, and the trade proposals, the first two have already been accepted by Great Britain, and the United States of America hopes that the acceptance of the third will follow. And if the two dominant nations become wedded to the liberal trade policy it is hoped that others would fall in line, if necessary as the result of the use of the same kind of lever.

It does not augur well for the triumph of the liberal trade and financial policies if there is a widespread British feeling, which may be shared by other nations, that such policies have been accepted under duress as a matter of Hobson's choice, that the practical limitations to the theoretical solution offered by non-discriminatory, multilateral trade have been conceived in such a way as to meet the specific needs of the American economy rather than the difficulties of other nations, and that the real problems of world trade and employment have been by-passed in the hope that the Bretton Woods Organization and the proposed International Trade Organization will automatically solve them. Nations like India who have to define a rational attitude to the world trade proposals cannot be indifferent to these issues.

The proposals aim at 'a substantial reduction of tariffs and the elimination of tariff preferences' in accordance with the guiding principles of Article VII of the Mutual Aid Agreements. The word 'substantial' is not defined. It may be argued that the American tariff has been so high that even a substantial reduction of the tariff may not stimulate imports into the U.S.A. It has been said that the Hull Trade Agreements after 1934 which resulted in striking reciprocal reductions in tariff were effective in stimulating American exports; their effect on imports was negligible. In any case, the reduction of tariffs, according to the trade proposals, is subject to an escape clause, 'to prevent sudden and widespread injury to the producers concerned.' What is needed in the case of the U.S.A. is not mere reduction of tariffs, but a policy of planning a level of costs and prices which will stimulate imports. Since this will mean transitional losses in protected industries it is doubtful whether such a policy will be favoured. Thus there is considerable doubt whether the U.S.A. can ever develop a considerable import surplus which is consistent with her rôle as the greatest creditor nation in history. Yet, until the U.S.A. has an import surplus stimulation of world trade and employment through liberal trading conditions will remain largely an aspiration.

While the undertaking to reduce tariffs is vague and its possible effects are uncertain, prohibition of 'tariff preferences' is absolute. The ban on tariff preferences will prevent Great Britain from seeking a planned development of her foreign trade in the difficult period of transition. It has long been assumed that Britain's export trade must increase by 50 per cent above the 1938 volume. The burden of the American loan will raise the figure to 75 per cent. Thus additional markets equal to one-fifth of the entire world trade will have to be won by Great Britain. This is possible, so the argument runs, if Great Britain can use the bargaining lever of her large import capacity. But this royal road has been blocked by the banning of tariff preferences. Bulk purchase agreements may also be interpreted as discriminatory trade practice and may not, therefore, be permissible. The trade proposals allow of quantitative import restrictions in the event of balance of payments difficulties. There is also

provision for waiver of interest in respect of the American loan in similar circumstances. But these provisions merely prescribe the strict regimen of cutting down imports, which means planning Britain's trade downwards to restore equilibrium in the balance of payments. What is consistent with full employment, however, is upward balancing which can be secured by reciprocity in trade relations.

The upshot of this trend of reasoning seems to be the conclusion that these proposals for expansion of world trade and employment reflect the American ambition to export and lend rather than the responsibilities of creditor status. It is felt that the U.S.A. wants the power to export and lend abroad as a means to full domestic employment without extensive public works and without serious alteration in the distribution of wealth. So she is anxious to use her political and economic power as a lever to upset the régime of New Protectionism implied by reciprocal bargains, preferences quotas, subsidies, blocked balances and exchange controls.

India is not interested in questions of power economics or power politics. As the writer has argued in this book, India's ultimate economic interests lie in the system of non-discriminating, multilateral trade. She will not mourn the passing of empire tariff preferences. As an economically undeveloped country she has no intention of exporting unemployment to other countries, but is more anxious to import employment from the rest of the world through trade as much as possible. But she cannot accept these proposals unless her right to developmental protection is recognized in specific terms and she is free to use such instrumentalities of trade regulation and control as are needed for averting economic collapse in the post-war period and for primary economic development. Since she has no commitments under Article VII of the Mutual Aid Agreement she can look at these proposals more objectively in her own economic interests as well as in the interests of world trade and employment.

The proposals abound in qualifications designed to freely adapt the basic postulates of free trading opportunities to present-day facts and circumstances. It is the permissible derogations from the orthodox principles of the liberal trade

policy which seem to be the apple of discord. It is necessary to review these practical limitations and qualifications and to see how far they would be consistent with a rational trade policy for India.

As regards reduction of tariffs and elimination of preferences, while India may abjure tariff preference, she must make it plain that since the height of the tariff in India depends upon revenue considerations to a large extent, international commitments should not unduly reduce her margin of fiscal discretion. Secondly, it should be emphasized that India would need developmental protection. Escape clauses relating to 'balance of payments difficulties' and 'sudden and widespread injury to domestic producers' are not enough, for they have been conceived in the context of the economic circumstances of countries like Great Britain and the U.S.A. Article 6 of Section A in Chapter VI provides that it will be a function of the world trade organization 'in accordance with criteria and procedures to be agreed upon, to waive particular obligations of members, in exceptional circumstances.' Some of the obligations which have been conceived in the light of the circumstances and needs of advanced industrial countries should be waived in the case of backward areas, and India should press for 'criteria' and procedures' governing the special treatment of these areas with regard to developmental protection.

Quantitative trade restrictions or prohibitions permissible during the early post-war period and, particularly, permissible restrictions on export of foodstuffs when there is a threat of famine, or on export or import of gold and silver, are proposals which would be readily accepted by India. Export or import quotas imposed under inter-governmental commodity control agreements and import quotas on agricultural products to enforce governmental measures (a) to restrict quantities of similar domestic products or (b) to dispose of temporary surplus of domestic products, are proposals conducive to stabilization of agricultural prices in India. Quantitative trade restrictions permitted to safeguard equilibrium in the balance of payments is an important exception to the general principle of non-discrimination which will protect India's economy particularly in the transitional period.

But India should press for permissibility of quotas as alternative to developmental tariff protection. She should, however, be prepared to allocate quotas on a non-discriminatory basis as explained by the author in the last chapter. In this connexion India should press for permission to impose quantitative restrictions of a discriminating character (a) if they have an equivalent effect to any exchange restrictions which India may be authorized to impose in conformity with Article VII of the Articles of Agreement of the International Monetary Fund; (b) if they are necessary for assisting a country whose economy has been disrupted by war; and (c) if they are necessary for utilizing, for the purchase of needed imports, inconvertible currencies already accumulated. (With the exception of (c) these provisions occur in Article 9 of the Financial Agreement between Britain and the U.S.A.).

The proposals do not condemn subsidies; they merely require that a country granting a subsidy should inform the world trade organization and be prepared to discuss it with other members. So far as export subsidies are concerned, it is proposed that differential home and export prices should cease within three years after the establishment of the world trade organization. But there is an escape clause in respect of commodities in 'burdensome world surplus.' India should welcome these proposals, for her agriculture, if not some of her domestic industries, may need 'internal income or price support,' specially in the transitional period, as part of the programme of stabilization of prices, income and employment.

Further, the proposals contemplate inter-governmental arrangements for the disposal of primary commodities in surplus supply, governed by the conclusions of study groups and by agreements running initially for not more than five years. India should welcome such a proposal which is calculated to stabilize the prices of primary products and prevent the terms of trade of primary countries from sharply moving against them. It is based on the recognition of the special character of disequilibrium between supply and demand in the case of these products. The provision for the long-range solution of the problem of surplus through a shift of resources from over-expanded branches of production as well as the provision for effective representation of consumer interests are reasonable

safeguards emphasized by the present author in Chapter IV. The scheme suggested in the course of these proposals is reasonable by comparison with the policies of the typical restriction schemes in the past.

There are two important gaps or deficiencies in these proposals which are aimed at expansion of world trade *and* employment. The first relates to the exaggerated emphasis which has been laid on trade as a means to full employment. The stimulus which trade gives to domestic employment depends obviously upon the significance of foreign trade for the economy of a country. Trade being an ancillary economic process, it is the high level of employment which is reflected in a large volume of trade, and not necessarily in a large total volume of foreign trade, or a large volume of foreign trade per head of population. Hence the primary economic objective should be expansion of world employment and not merely expansion of world trade which *may* be a means to fuller employment for *some* countries. The positive measures required to attain this objective are co-ordination of the recovery programmes of at least the major countries (for which the proposals contemplate *full* employment), agreement among nations, or at least groups of nations, to mitigate one another's depressions, and maintaining the terms of trade of primary countries at a reasonably high level. With the exception of the proposal for 'exchange of information and participating in consultations with respect to anti-depression measures' and the proposal for commodity agreements with the limited object of protecting primary producers when there is a glut, there is no mention of any positive measures to tackle the problem of world employment. It seems as if there is too much insistence on negative measures—reduction of tariffs and removal of trade barriers.

The second drawback of these proposals is that they do not go far in trying to tackle the problem of international cartels: Cartels, price-fixing arrangements, division of markets, restriction of production and suppression of inventions are rightly condemned without any reservation. But the means suggested are feeble and ineffective. A victim can only complain to the world trade organization. An enquiry will be set on foot and a report made, and the organization

would only 'make recommendations to the appropriate members for action in accordance with their respective laws and procedures.' In this case it will rely on individual and concerted efforts by members of the organization, but no international commercial code is recommended. It would be futile to believe that the technique of consultation and persuasion can curb national and international cartels. And so long as they can rest in peace and have little to fear the issue of reduction of tariffs and removal of trade barriers pales into insignificance.

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Printed by G. S. Press, Madras.
P. I. C. M. S. 97 for Indian Council of World Affairs, Delhi. 28-8-46.